(1)
S[illegible]ourt, U.S.
L E D
95 1063 JAN 2 - 1996
OFFICE OF THE CLERK

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1995

WILLIAM B. BLOUNT,

Petitioner,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The District Of Columbia Circuit

PETITION FOR A WRIT OF CERTIORARI

KEVIN T. BAINE*
ROBERT B. BARNETT
ERIK S. JAFFE
KEVIN M. DOWNEY
WILLIAMS & CONNOLLY
725 12th St., N.W.
Washington, D.C. 20005
(202) 434-5000

ANDREW P. CAMPBELL
LEITMAN, SIEGAL, PAYNE & CAMPBELL, P.C.
600 North 20th St., Suite 400
Birmingham, Alabama 35203
(205) 251-5900

Attorneys for Petitioner

**Counsel of Record*

151 pp

QUESTIONS PRESENTED FOR REVIEW

1. Whether the First Amendment permits the Securities and Exchange Commission effectively to prohibit municipal bond professionals from making or soliciting any political contributions, however small, to certain candidates for state and local office.

2. Whether the Tenth Amendment permits an agency of the *federal* government to regulate *state* political activity and effectively to prohibit certain financial dealings by the States, absent an unmistakably clear statement of intent by Congress that it may do so.

PARTIES TO THE PROCEEDING BELOW

The parties to the proceeding in the United States Court of Appeals for the District of Columbia Circuit are those set forth in the caption and the Municipal Securities Rulemaking Board, as intervenor. The parties have no parent companies or subsidiaries.

TABLE OF CONTENTS

QUESTIONS PRESENTED FOR REVIEW i

PARTIES TO THE PROCEEDING BELOW ii

TABLE OF AUTHORITIES iv

OPINIONS AND ORDERS BELOW 1

JURISDICTION 2

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED 2

STATEMENT OF THE CASE 3

REASONS FOR GRANTING THE WRIT 9

I. The Case Involves Questions of National Importance 9

II. The Decision Conflicts with the Rationale of *Buckley v. Valeo* 11

III. The Decision Conflicts with the Rationale of Controlling Tenth Amendment Precedents 18

CONCLUSION 21

APPENDICES A-1

TABLE OF AUTHORITIES

CASES:

Atascadero State Hospital v. Scanlon,
473 U.S. 234 (1985) 18
Bolger v. Youngs Drug Products Corp.,
463 U.S. 60 (1983) 13
Buckley v. Valeo,
424 U.S. 1 (1976) 11, 12, 13, 15, 16
California State Board of Optometry v. FTC,
910 F.2d 976 (D.C. Cir. 1990) 18, 19
Citizens Against Rent Control v. City of Berkeley, 454 U.S. 290 (1981) 16
Garcia v. San Antonio Metropolitan Transit Authority, 469 U.S. 528 (1985) 18, 19, 20
Gregory v. Ashcroft,
501 U.S. 452 (1991) 18, 20
Mills v. Alabama,
384 U.S. 214 (1966) 18
Rosenberger v. Rector and Visitors of the University of Virginia,
115 S. Ct. 2510 (1995) 13
SEC v. Lowe,
556 F. Supp. 1359 (E.D.N.Y. 1983),
aff'd, 779 F.2d 36 (2d Cir. 1985) 16
South Carolina v. Baker,
485 U.S. 505 (1988) 8, 21
Tashjian v. Republican Party of Connecticut,
479 U.S. 208 (1986) 20

CONSTITUTIONAL, STATUTORY AND REGULATORY PROVISIONS:

U.S. Const. amend. I 2, 5, 9, 16, 18
U.S. Const. amend. X 2, 8, 9, 18, 20, 21

2 U.S.C. § 437h 11
15 U.S.C. § 78*dd*-1(a) 3
15 U.S.C. § 78*o*-4(b) 3
15 U.S.C. § 78*s* 3, 7
15 U.S.C. § 78*y* 7
28 U.S.C. § 1254(1) 2

11 C.F.R. Part 110 10

Rule G-37 . . . . . *passim*

Alaska Stat. § 15.13.070(a) 10
Cal. Gov. Code § 85301(a) 10
Flor. Stat. Ann. § 106.08 10

MISCELLANEOUS:

The Supreme Court, 1990 Term—Leading Cases, 105 Harv. L. Rev. 177 (1991) 19

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1995

WILLIAM B. BLOUNT,

Petitioner,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

On Petition For A Writ Of Certiorari
To The United States Court Of Appeals
For The District Of Columbia Circuit

William B. Blount respectfully petitions this Court for a writ of certiorari to review the judgment of the United States Court of Appeals for the District of Columbia Circuit.

OPINIONS AND ORDERS BELOW

The August 4, 1995 opinion of the United States Court of Appeals for the District of Columbia Circuit is reported at 61 F.3d 938 and is reproduced at Appendix ("App.") A. The court of appeals' October 4, 1995 orders denying petitioner's request for rehearing and suggestion for rehearing *in banc* are reproduced at App. F.

The April 7, 1994 Securities and Exchange Commission ("SEC") order approving the Rule under review is reproduced at App. B. The April 7, 1994 SEC order preliminarily considering whether to issue a stay *sua sponte* and establishing guidelines for seeking stay applications is

reproduced at App. C. The May 4, 1994 SEC order denying the application of William B. Blount for a stay is reproduced at App. D. The May 6, 1994 order of the United States Court of Appeals for the District of Columbia Circuit, granting in part and denying in part William B. Blount's request for a stay is reproduced at App. E.

JURISDICTION

The court of appeals' opinion and judgment were entered on August 4, 1995. The orders denying petitioner's timely filed petition for rehearing and suggestion for rehearing *in banc* were entered on October 4, 1995. This petition is filed within 90 days of those orders. This Court has jurisdiction under 28 U.S.C. § 1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The First Amendment to the United States Constitution provides, in relevant part, that:

> Congress shall make no law . . . abridging the freedom of speech . . . .

The Tenth Amendment to the United States Constitution provides that:

> The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people.

15 U.S.C. § 78*o*-4(b), relating to the authority of the Municipal Securities Rulemaking Board ("MSRB") to propose rules, is reproduced, in relevant part, at App. G-1 to G-2.

15 U.S.C. § 78*s*, relating to the SEC's authority to approve rules proposed by the MSRB, is reproduced, in relevant part, at App. G-2.

Rule G-37, the SEC-approved Rule under consideration in this case, is reproduced, in relevant part, at App. G-3 to G-4.

STATEMENT OF THE CASE

In August 1993, the Municipal Securities Rulemaking Board ("MSRB"), a self-regulatory organization established by Congress to develop rules governing the municipal securities business, 15 U.S.C. § 78*o*-4(b), published a draft rule that would have prohibited municipal securities dealers from making contributions to state and local government officials "for the purpose of obtaining or retaining" municipal securities business. JA 789.[1] Draft Rule G-37 was modeled after the Foreign Corrupt Practices Act[2] and did not contain the provisions currently being challenged. After receiving

---

[1] "JA" refers to the Joint Appendix filed in the court of appeals and containing the record on review.

[2] The Foreign Corrupt Practices Act, 15 U.S.C. § 78*dd*-1(a), prohibits certain payments to "any foreign official *for purposes of* . . . [influencing or inducing specified acts or omissions] in order to assist [a securities issuer or domestic concern] in obtaining or retaining business for or with, or directing business to, any person . . ." (emphasis added).

comments on the Draft Rule, the MSRB in January 1994 submitted a revised Rule G-37 to the SEC for its approval. JA 644. The revised Rule, which went well beyond the original proposal, contained the provisions that are the subject of this case:

- Rule G-37(b), which provides: "No broker, dealer or municipal securities dealer shall engage in municipal securities business with an issuer within two years after any contribution to an official of such issuer made by" the broker, dealer or associated "municipal finance professional," except for a contribution not exceeding $250 by a municipal finance professional to a candidate for whom he is entitled to vote.

- Rule G-37(c), which provides: "No broker, dealer or municipal securities dealer or any municipal finance professional . . . shall solicit any person or political action committee to make any contribution, or shall coordinate any contributions, to an official of an issuer with which the broker, dealer or municipal securities dealer is engaging or is seeking to engage in municipal securities business."[3]

Subsection (b) of the MSRB's revised proposal, which effectively prohibited certain campaign contributions

---

[3] These provisions are supplemented by Rule G-37(d), which provides that no regulated entity "shall, directly or indirectly, through or by any other person or means, do any act which would result in a violation of sections (b) or (c) of this rule."

altogether, was responsive to the concerns of some commentators, who felt that it would be difficult to determine whether a contribution was made for the purpose of obtaining or retaining business. Subsection (c), on the other hand, which banned all solicitation of contributions to certain candidates, was added by the MSRB almost as an afterthought and with no explanation whatsoever of the reason or need for it. *See* JA 657.[4] The MSRB did not consider any potential First Amendment problems with its proposed Rule, because it mistakenly thought that the Rule was private action that did not have to conform with the First Amendment. JA 671.[5]

After additional notice and opportunity for comment, the SEC approved Rule G-37 by order dated April 7, 1994. App. B. Unlike the MSRB, the SEC acknowledged that the Rule's contribution limitation infringed First Amendment "speech and associational rights." App. B-36. The SEC, however, found the infringement justified by several interests. First, the SEC explained, the Rule would advance the "interest in preventing fraudulent and manipulative acts and

---

[4] Only two of the numerous commentators suggested any restriction on the solicitation of contributions. One of those simply recommended a ban on soliciting contributions from other municipal securities employees covered by the Rule. JA 850. Only one commentator mentioned a ban on all solicitations to certain candidates. JA 841. That suggestion, which was contained in a single sentence and unaccompanied by any explanation, was made by the MSRB Chairman's firm, Goldman Sachs & Co.

[5] The MSRB has adhered to this position throughout this litigation. The court of appeals rejected it, noting that "Rule G-37 constitutes government action of the purest sort." App. A-7.

practices, as well as the appearance of fraud and manipulation, in the municipal securities market." App. B-28. In short, the Rule would offer a measure of "investor protection." App. B-29 to B-30. Second, the SEC concluded that the Rule would "perfect the mechanism of a free and open market for municipal securities" by eliminating "artificial barriers to competition for those firms that either cannot afford or decide not to make political contributions." App. B-32. Third, the Commission claimed that the Rule would "promote just and equitable principles of trade." App. B-33.[6]

The SEC did not address subsection (c)'s ban on the solicitation of contributions, except in a footnote noting that the provision was "intended to prevent circumvention" of the contribution limitations. App. B-38 n.68. There was no recognition by the SEC of the special problems presented by subsection (c)'s attempt to regulate the content of political speech.

At the same time that it approved Rule G-37, the SEC issued an order preliminarily considering whether to issue a stay *sua sponte*, rejecting such a stay, and establishing procedures for third parties to request a stay of the Rule pending judicial review. App. C. On April 25, 1994, petitioner William B. Blount timely sought a stay of the SEC's approval order pending judicial review.

---

[6] The Commission also noted that the Rule would foster cooperation and coordination in regulating municipal securities transactions and that its records and record retention provisions were consistent with statutory authority. App. B-33 to B-34. These records provisions are not being challenged here.

On April 26, 1994, petitioner timely filed a petition for review of the SEC's approval order in the United States Court of Appeals for the District of Columbia Circuit. The jurisdiction of the court of appeals was based upon 15 U.S.C. § 78*y* and 15 U.S.C. § 78*s*. The MSRB sought, and was allowed, to participate as an intervenor in support of the SEC.

Because the SEC had not yet ruled on petitioner's application for a stay, petitioner moved, on April 29, 1994, for a stay of the SEC's order pending judicial review. The SEC opposed the motion for a stay and, on May 4, 1994, denied petitioner's application to the SEC for a stay. App. D. On May 6, 1994, the court of appeals granted petitioner's motion in part and denied it in part, staying the Rule's solicitation ban as it applied to the petitioner. App. E.

The court of appeals denied the petition for review on August 4, 1995. At the outset, it rejected the MSRB's contention that the Rule was non-governmental action. App. A-5 to A-7. The court then proceeded to uphold the Rule on the merits. As the court of appeals summarized the record, the Commission's justifications for the Rule contained two asserted interests: "(1) protecting *investors* in municipal bonds from fraud and (2) protecting *underwriters* of municipal bonds from unfair, corrupt market practices." App. A-14 (emphasis added). The court rejected the SEC's position that the Rule could be justified by the first of these two interests—the need to protect investors. In the absence of any "data" to support the Commission's position, the court "share[d] the petitioner's skepticism" that so-called pay-to-play practices had caused any "harm to investors." App. A-16. Moreover, the court noted, "[i]f the Commission's goals were only to protect the investing public, disclosure [of

contributions] and record-keeping requirements might do the job." App. A-21.

The court concluded, however, that the Rule was necessary to achieve the SEC's second "compelling" interest—protecting underwriters from unfair and corrupt practices. The "link" between the Rule and that interest was, in the court's opinion, "self-evident." App. A-17. And the Rule was narrowly tailored to advance that interest, the court concluded, because "none of the alternatives presented would be even *almost* equally effective." App. A-22. The prohibition on the solicitation of contributions was necessary, the court noted, because otherwise "underwriters could easily circumvent the prohibition against direct contributions." App. A-22.

The court of appeals dismissed petitioner's Tenth Amendment challenge with three observations: first, that "Rule G-37 neither compels the states to regulate private parties . . . nor regulates the states directly"; second, that the Rule did not have the "preemptive effect on states' ability to control their own electoral process that might be perceived as 'destructive of state sovereignty'"; and third, that "*Congress* is [not] disabled from regulating private persons in their conduct of interstate trade in municipal securities." App. A-26 (emphasis added). The court did not address the fact that an *administrative agency*, not Congress, was responsible for Rule G-37, nor did it comment upon petitioner's argument that Rule G-37 *effectively* regulated the States, just as in the case of *South Carolina v. Baker*, 485 U.S. 505 (1988).

Petitioner timely sought a rehearing, and suggested a rehearing *in banc*, both of which the court of appeals denied on October 4, 1995. App. F.

REASONS FOR GRANTING THE WRIT

I. THE CASE INVOLVES QUESTIONS OF NATIONAL IMPORTANCE

Rule G-37 places unprecedented restrictions on the First Amendment rights of municipal securities professionals and the Tenth Amendment rights of the States:

- The Rule effectively prohibits municipal securities professionals from making any contribution of any amount to certain candidates. More significantly, the Rule regulates the content of political speech by prohibiting municipal securities professionals from soliciting contributions to certain candidates for public office. *It is, in fact, the only provision of federal law that prohibits a private citizen from soliciting a lawful political contribution.*

- Through this Rule, an agency of the *federal* government has prohibited certain forms of individual political activity at the *state* and *local* level, and has prohibited financial dealings between the *States* and certain private entities. It is the only federal regulatory provision that displaces the authority of the States over their own elections without express statutory or constitutional authority.

The restrictions imposed by Rule G-37 go far beyond the provisions of the Federal Election Campaign Act. That law requires the disclosure of contributions and imposes

limitations on the size of contributions. 2 U.S.C. §§ 434, 441a; 11 C.F.R. Part 110. Most States have adopted similar disclosure requirements and contribution caps. *See, e.g.*, Alaska Stat. § 15.13.070(a) ($1000 annual contribution cap); Cal. Gov. Code § 85301(a) (same); Florida Stat. Ann. § 106.08 ($500 contribution cap per election); *see also* App. B-39 n.69 (SEC noting state contribution ceilings even lower than the general federal contribution ceiling).

Not content with existing limits on state political activity, the SEC has taken it upon itself effectively to (1) prohibit contributions to certain candidates altogether and (2) dictate what private citizens may say in the course of a political campaign. Those subject to the Rule may deliver a speech saying that a candidate for certain offices "deserves your vote," but may not say that the candidate "needs your financial support."

Never before has an agency of the federal government sought to impose any such restriction on the content of political speech by private citizens advocating entirely lawful activity. Never before, in fact, has an agency of the *federal* government sought to impose *any* restriction on the participation of private citizens in *state* political activity. In both of these respects, this Rule—and the decision of the court of appeals upholding it—are unprecedented.

Review of the court of appeals' decision is warranted both because of its far-reaching practical impact and its ground-breaking legal importance. By upholding this Rule, the court of appeals has curtailed the ability of private citizens in every state and municipality in this country to participate in the political process. At the same time, it has displaced the authority of every state and municipality to regulate the

conduct of its own elections. These effects are drastic and they are ongoing. The time to consider whether they are warranted is now—on direct review of the Rule, before the Rule works irreparable mischief in state and local elections throughout the country.[7]

Because Rule G-37 systematically restricts the core political speech of countless numbers of private citizens, and because it interferes with state and local regulation of elections as well as state and local bond business, it raises questions of national importance that warrant this Court's review.

II. THE COURT OF APPEALS' DECISION CONFLICTS WITH THE RATIONALE OF *BUCKLEY v. VALEO*

The court of appeals' decision upholding Rule G-37 cannot be squared with the principles underlying this Court's decision in *Buckley v. Valeo,* 424 U.S. 1 (1976). In that case, the Court struck down campaign laws that "place[d] substantial and direct restrictions on the ability of . . . citizens

---

[7] When Congress enacted the Federal Election Campaign Act—an act that imposed restrictions far less severe than this Rule, *see* pp.12-13, *infra*—it recognized the importance of providing for prompt Supreme Court review. The Act contained provisions directing that constitutional questions be certified "immediately" to the court of appeals, authorizing a direct appeal to this Court, and directing that review be "expedite[d] to the greatest extent possible." 2 U.S.C. § 437h. The same considerations that prompted Congress to provide for immediate review of the Federal Election Campaign Act's restrictions on political activity warrant this Court's early review of Rule G-37's more extreme restrictions.

. . . to engage in protected political expression." *Id.* at 58-59. There could be no more "substantial and direct restriction" on the fundamental right of political expression than a restriction on the permissible content of a political message. And that is what Rule G-37(c) imposes—a restriction on what a private individual may say in the context of a political campaign.

In *Buckley*, this Court emphasized that "the constitutional guarantee [of freedom of speech] has its fullest and most urgent application precisely to the conduct of campaigns for political office." 424 U.S. at 15 (citation omitted). The Court proceeded to uphold provisions of the Federal Election Campaign Act that required disclosure of campaign contributions and that established ceilings on contributions to candidates, but it struck down a provision that prohibited independent expenditures in support of a candidate. "[A] limitation upon the amount that any one person or group may contribute to a candidate," the Court explained, "entails only a marginal restriction upon the contributor's ability to engage in free communication." *Id.* at 20-21. The limitation on independent expenditures, on the other hand, "impose[s] significantly more severe restrictions on protected freedoms of political expression and association." *Id.* at 23. Unlike the contribution ceiling, the independent expenditure ceiling, the Court held, "place[s] substantial and direct restrictions on the ability of . . . citizens . . . to engage in protected political expression, restrictions that the First Amendment cannot tolerate." *Id.* at 58-59.

Rule G-37's effective prohibition against contributions in any amount to certain candidates, and its flat-out ban on the solicitation of contributions, place even more "substantial" and more "direct restrictions on the ability of . . . citizens . . . to engage in protected political expression" than the

independent expenditure ceiling struck down in *Buckley*. *Id.* The ban on the solicitation of contributions is particularly offensive, because it violates the fundamental principle that "the government may not regulate speech based on its substantive content or the message it conveys." *Rosenberger v. Rector and Visitors of the University of Virginia,* 115 S. Ct. 2510, 2516 (1995). The solicitation ban dictates what an individual may say and what he may not say when he enters the political arena: he may ask for votes, but he may not ask for contributions. For the first time in this country, private citizens must watch their words when they engage in political speech. They may say that a certain candidate "needs your vote," but they may not say that he "needs your financial support."[8] A particular political message is off-limits. And the prohibited message is an important one, for it is difficult to wage a successful election campaign without a successful fundraising effort.

"[O]nly in the most extraordinary circumstances" has the Supreme Court sustained a content-based restriction on noncommercial speech. *Bolger v. Youngs Drug Products Corp.,* 463 U.S. 60, 65 (1983). And under *no* circumstances has the Supreme Court, or any court for that matter, sustained a restriction on the content of routine *political* speech by private citizens—speech to which the First Amendment has its "fullest and most urgent application." *Buckley,* 424 U.S. at 15 (citation omitted).

---

[8] The prohibition applies not only to solicitations for the benefit of an official who has given the dealer business, but also solicitations to defeat such an official or to reelect an official who has declined to give the dealer business. In short, the prohibition applies regardless of whether the solicitation might reasonably be regarded as part of some *quid-pro-quo* arrangement.

The court of appeals applied "strict scrutiny" to the Rule and concluded that it was "narrowly tailored" to advance a "compelling" government interest. App. A-13. It is difficult to accept that conclusion, however, when the court of appeals acknowledged that "the record contains only *allegations*" of abuses, not *evidence* or *findings*, and that the Rule was not necessary to advance its principal objective after all. *Id.* A-16 (emphasis added).

The court of appeals thought it sufficient to warrant a prophylactic rule that there was a "likelihood" of "pay to play" practices, which it understood as "bring[ing] the donor merely a chance to be seriously considered, not the assurance of a contract." *Id.*. The court of appeals agreed with the petitioner, however, that the Rule was not necessary to advance the first of the two "compelling" interests invoked by the Commission to justify the Rule—"protecting investors in municipal bonds from fraud." *Id.* A-14. "Even assuming the prevalence of quid pro quos" (a matter as to which it agreed there was no evidence), the court of appeals "share[d] the petitioner's skepticism" that there would be any "harm to investors" as a result. *Id.* A-16. Moreover, the court explained, "[i]f the Commission's goals were only to protect the investing public, disclosure and record-keeping requirements might do the job." *Id.* A-21.

The court of appeals upheld the Rule based solely on the Commission's secondary objective—"protecting *underwriters* of municipal bonds from unfair, corrupt practices." *Id.* A-14 (emphasis added). The court accepted the Commission's explanation that protecting firms that "either cannot afford or decide not to make political

contributions" advanced the goals of a free market and equitable principles of trade. App. A-17.[9]

Simply to identify these laudable objectives, however, does not justify the extreme restrictions that this Rule works on political freedom. Perhaps these goals can justify the Rule's $250 ceiling on contributions to candidates for whom an individual is entitled to vote—a "marginal" restriction on political freedom. *Buckley,* 424 U.S. at 20. But how can they justify an effective ban on contributions to other candidates? Is there a danger that a $250 contribution will corrupt the process of selecting municipal securities underwriters?

And how can the interest identified by the court of appeals justify a ban on solicitation that amounts to censorship of political speech? The court of appeals accepted the SEC's answer that without the ban on solicitation of contributions, "underwriters could easily circumvent the prohibition against direct contributions." App. A-21 to A-22. But the independent expenditure ceiling in *Buckley* also was justified as a measure to prevent circumvention of a contribution provision, and that justification was rejected for reasons that also apply here. First, the provision's "effectiveness as a loophole-closing provision" is "undermine[d]" by the fact that individuals can curry just as much favor with candidates by soliciting votes and engaging in other campaign activity as they can by soliciting contributions. *Buckley,* 424 U.S. at 45. And second, as in

---

[9] The court of appeals did not find, however, that the unfair selection of underwriters was a significant problem, but instead decided that the mere possibility of such unfair treatment was sufficient to justify the Rule as a prophylactic measure. App. A-16.

Buckley, the solicitation of contributions "does not presently appear to pose dangers of real or apparent corruption comparable to those identified with" the making of contributions. *Id.* at 46. In fact, *not a single commentator before the MSRB or the SEC—110 in all—even suggested that the solicitation of contributions had posed an actual problem.*

Rule G-37 is a textbook example of overkill—an extreme measure adopted in the single-minded pursuit of a laudable goal without any real consideration of the impact on First Amendment rights and without any real consideration of whether the Rule's most drastic provisions are truly necessary. There is, as the court of appeals acknowledged, App. A-16, no evidence that municipal securities business has ever been awarded because of a political contribution, only a perception that it has.[10] There is not even a *perception* that business has been awarded because of small contributions under $250. And there has never been a suggestion by anyone that business has been awarded because of the mere solicitation of contributions. In short, there is no evidence of

---

[10] The Commission made no finding on the extent of political contributions by underwriters or the extent to which business has been awarded based on contributions. An earlier staff report contained the frank admission that the staff was "unable" to draw conclusions on these issues. JA 85. Recognizing the deficient state of the record regarding *actual* abuses, the Commission took the position in the court of appeals that the Rule could be justified as an effort to combat "perceived abuses" that "diminish[] investor confidence." JA 1061, 1074. Of course, disclosure requirements would adequately address problems of perception. *See Citizens Against Rent Control v. City of Berkeley*, 454 U.S. 290, 299-300 (1981); *SEC v. Lowe*, 556 F. Supp. 1359, 1366 (E.D.N.Y. 1983), *aff'd*, 779 F.2d 36 (2d Cir. 1985).

any substantial danger, real or perceived, that would not have been addressed fully by a contribution ceiling and a disclosure requirement—the kinds of remedies upheld by this Court in *Buckley*.

If this Rule's prohibitions can be upheld on the record in this case—based on the possibility that even a $250 contribution or the mere solicitation of a contribution may influence government action—then similar bans could be imposed on anyone who stands to gain from any action of government. On the state and federal level, countless individuals and entities have an interest in virtually every action of the executive and legislative branches.[11] But citizens' interest in governmental decisions has never been thought sufficient to justify prohibiting them from making even a token contribution to a candidate or from urging others to support a candidate. To be sure, extreme measures like these will minimize the risk that government officials will be influenced in their official actions by their need for campaign

---

[11] The court of appeals itself noted that the "class of people" who would be covered by the Rule's rationale would be "very broad"—including "all who benefit in their business from government activity creating a market for their goods or services (from lawyers specializing in SEC work to suppliers of environmental control technology); all whose businesses benefit from the imposition of regulatory, tax, or tariff restrictions on competitors or potential competitors; all whose income enjoys any kind of tax advantage; and all who are employed by or otherwise economically dependent on firms fitting the description above," as well as "anyone who (directly or indirectly) is seeking to receive any such benefits and anyone seeking to stave off either the cancellation of existing benefits or the imposition of new burdens." App. A-11 to A-12.

funds. But that is a risk that is inherent in today's political system—and that is held in check by the very provision of the Bill of Rights that is infringed by this Rule. The First Amendment itself provides "a powerful antidote to any abuses of power by governmental officials." *Mills v. Alabama*, 384 U.S. 214, 219 (1966). And at some point, the protection against political corruption must come not from further restrictions on political freedom, but from the guarantees that contributions are made in the open and that citizens have the freedom to subject those contributions and those who receive them to scrutiny.

III. THE COURT OF APPEALS' DECISION CONFLICTS WITH THE RATIONALE OF CONTROLLING TENTH AMENDMENT PRECEDENTS

The court of appeals' treatment of the Tenth Amendment issue in this case conflicts with a series of decisions by this Court. The controlling case law imposes limitations on the power of administrative agencies to regulate in areas, such as state elections, that are fundamental to the States as sovereigns. *Gregory v. Ashcroft*, 501 U.S. 452 (1991); *Garcia v. San Antonio Metropolitan Transit Authority*, 469 U.S. 528 (1985); *California State Board of Optometry v. FTC*, 910 F.2d 976, 981 (D.C. Cir. 1990). The court of appeals observed that "*Congress* is [not] disabled from regulating" the conduct at issue here. App. A-26 (emphasis added). But the point, unaddressed by the court of appeals, is that *Congress* has *not* acted, and that in the absence of an "unmistakably clear" statement by Congress, an *administrative* agency *is* disabled from regulating on matters fundamental to the States as sovereigns. *See Gregory*, 501 U.S. at 460 (citation omitted); *Atascadero State Hospital v. Scanlon*, 473

U.S. 234, 242 (1985); *California State Board,* 910 F.2d at 981.

The requirement of an "unmistakably clear" statement of Congressional intent is intended precisely to prevent what has happened in this case—an unwarranted intrusion by the federal government into matters of state sovereignty. The States' participation in the election of representatives to Congress "ensures that laws that unduly burden the States will not be promulgated" by the Congress. *Garcia*, 469 U.S. at 556. But the States do not enjoy the same "built-in" protections when it comes to regulatory action. *Id.* "Unlike Congress, administrative agencies do not in any sense represent the interests of the states." *The Supreme Court, 1990 Term—Leading Cases,* 105 Harv. L. Rev. 177, 204 (1991). To permit administrative agencies to act unilaterally on matters of vital interest to the States as sovereigns, without a clear authorization by Congress, "would short-circuit the protections offered States by the political process." *California State Board*, 910 F.2d at 981.

The SEC's broad rulemaking authority does not contain any "unmistakably clear" statement of intent that would authorize displacing the States' authority over their own election campaigns. Indeed, before this Rule was promulgated, the SEC made clear that it understood the limits of its authority in this area. When the Commission Chairman was questioned at a Congressional hearing before Rule G-37 assumed its present form, he assured the Congress that he was "exceedingly reluctant at any time to impose Federal involvement in State activities of any kind," and that "the ability of the Commission, or the Congress for that matter, to involve themselves in this area is extremely limited except again to push toward a solution." JA 298. The

Commission's subsequent reversal of course violated that assurance, exceeded the statutory authority conferred by Congress, and violated the Tenth Amendment.

The court of appeals minimized the impact of the Rule on the States, noting that it "does not have anything resembling the kind of preemptive effect on states' ability to control their own election processes that might be perceived as 'destructive of state sovereignty.'" App. A-26 (quoting *Garcia*, 469 U.S. at 554). But there is no doubt that this Rule displaces the power of the States to regulate their own election campaigns: the States cannot permit campaign contributions and solicitations that the Rule forbids. And there is no doubt that "'the Framers of the Constitution intended the states to keep for themselves, as provided in the Tenth Amendment, the power to regulate elections.'" *Gregory*, 501 U.S. at 461-62 (citation omitted); *see also Tashjian v. Republican Party of Connecticut*, 479 U.S. 208, 217 (1986) ("the Constitution grants to the States a broad power [to regulate Congressional elections] . . . which power is matched by state control over the election process for state offices").

Rule G-37 "goes beyond an area traditionally regulated by the States" into an area that involves choices "of the most fundamental sort for a sovereign entity." *Gregory*, 501 U.S. at 460. For if sovereignty means anything, it surely means that the States have the power to regulate their own election campaigns, free from overriding federal regulations.[12]

---

[12] It is no answer to the Tenth Amendment problem to say that the Rule does not "regulate[] the states directly" or "compel[] the states to regulate private parties." App. A-26. That was true

(continued...)

CONCLUSION

Rule G-37 does violence to basic constitutional principles, to the fundamental political rights of citizens, and to the sovereign power of the States. Review is warranted to clarify the principles that govern the regulation of political activity, to undo the damage that Rule G-37 is causing on a continuing, nationwide basis, and to eliminate the danger that this Rule, the first of its kind, will be seen as a precedent.

---

[12](...continued)
in *South Carolina v. Baker,* 485 U.S. 505 (1988)—a case in which the Supreme Court reviewed a statute that deprived private citizens of the generally applicable tax exemption for interest earned on municipal bonds unless those bonds were issued in registered form. The statute did not directly regulate the States, but that did not foreclose a Tenth Amendment challenge. It was assumed sufficient to trigger the Tenth Amendment's provisions that the law "effectively require[d] states to issue bonds in registered form." *Id.* at 511. It is even more clearly the case that Rule G-37 effectively requires the States to do business only with certain municipal securities dealers. And it just as effectively prohibits the States from permitting the kind of election activity that Rule G-37 forbids. The court of appeals did not mention *South Carolina v. Baker.*

Respectfully submitted,

KEVIN T. BAINE*
ROBERT B. BARNETT
ERIK S. JAFFE
KEVIN M. DOWNEY
WILLIAMS & CONNOLLY
725 12th St., N.W.
Washington, D.C. 20005
(202) 434-5000

ANDREW P. CAMPBELL
LEITMAN, SIEGAL, PAYNE & CAMPBELL, P.C.
600 North 20th St., Suite 400
Birmingham, Alabama 35203
(205) 251-5900

Attorneys for Petitioner

**Counsel of Record*

TABLE OF CONTENTS

Appendix A:
Opinion of the Court of Appeals to be Reviewed, August 4, 1995 . . . . . A-1

Appendix B:
Securities and Exchange Commission Order Approving Proposed Rule Change by the Municipal Securities Rulemaking Board Relating to Political Contributions, etc., April 7, 1994 . . . . . B-1

Appendix C:
Securities and Exchange Commission Order Preliminarily Considering Whether to Issue Stay Sua Sponte and Establishing Guidelines for Seeking Stay Applications, April 7, 1994 . . . . . C-1

Appendix D:
Securities and Exchange Commission Order Denying Application of William B. Blount for a Stay, May 4, 1994 . . . . . D-1

Appendix E:
Order of the Court of Appeals granting in part and denying in part petitioner's motion for a stay pending review, May 6, 1995 . . . . . E-1

Appendix F:
Orders of the Court of Appeals denying rehearing and rehearing *in banc*, October 4, 1995 . . . F-1

Appendix G:
Statutory and regulatory provisions G-1

APPENDIX A

William B. BLOUNT, Petitioner,

v.

SECURITIES AND EXCHANGE COMMISSION, Respondent,

Municipal Securities Rulemaking Board, Intervenor.

No. 94-1336

United States Court of Appeals,
District of Columbia Circuit.

Argued Dec. 9, 1994.

Decided Aug. 4, 1995.

Rehearing and Suggestion for Rehearing
In Banc Denied Oct. 4, 1995

On Petition for Review of an Order of the Securities and Exchange Commission.

Kevin T. Baine, Washington, DC, argued the cause, for petitioner. With him on the briefs, were Robert B. Barnett, Erik S. Jaffe, Lawrence Shore and Kevin M. Downey, Washington, DC.

Simon M. Lorne, Gen. Counsel, S.E.C., Washington, DC, argued the cause, for respondent. With him on the brief, were Jacob H. Stillman, Associate Gen. Counsel, and Eric Summergrad, Principal Asst. Gen. Counsel, S.E.C.,

Washington, DC. Paul Gonson, Washington, DC, entered an appearance, for respondent.

Harvey L. Pitt, Washington, DC, argued the cause, for intervenor. With him on the brief, was James H. Schropp, Washington, DC.

Before: WILLIAMS, HENDERSON and ROGERS, Circuit Judges.

STEPHEN F. WILLIAMS, Circuit Judge:

In late 1993, regulators of the municipal securities markets began to investigate reports that brokers and dealers were engaging in a variety of ethically questionable practices in order to secure underwriting contracts. These practices, often lumped together under the label "pay to play", include as a paradigmatic example the making of political contributions to state and local officials who may influence the choice of underwriter. Concerned that such practices were becoming more prevalent and were undermining the integrity of the $ 250 billion municipal securities market, the Municipal Securities Rulemaking Board ("MSRB" or "Board") drafted several new rules, which were then approved by the Securities and Exchange Commission. Among these was Rule G-37, the rule challenged in this case. See SEC Release No. 34-33868 (April 7, 1994) (order approving proposed rule change) ("*SEC Approval Order*").

The two principal sections of Rule G-37, (b) and (c), together restrict the ability of municipal securities professionals to contribute and to solicit contributions to the political campaigns of state officials from whom they obtain business. Section (d) serves as a loophole-closer, prohibiting

indirect violations of the restrictions in (b) or (c). We describe each in turn.

Contributions. Section (b) prohibits any "broker, dealer, or municipal securities dealer" who has contributed "to an official of [an] issuer" from "engaging in municipal securities business with [that] issuer" for a period of two years after the contribution.[1] Contributions by a "municipal finance professional associated" with the broker or dealer are treated as equivalent to contributions by the broker or dealer itself; as are contributions by a political action committee "controlled" either by the broker or dealer or by "any municipal finance professional" whatsoever. The two-year restriction on business is not triggered, however, by any of these various parties' contribution of up to $ 250 per official per election to an official for whom that party is entitled to vote.

Solicitations. Section (c) prohibits brokers, dealers, and municipal securities dealers—as well as their associated municipal finance professionals—from soliciting or coordinating contributions to officials of any issuer with whom the broker, etc., is "engaging or is seeking to engage in municipal securities business."

Loophole-closer. Section (d) prohibits brokers, dealers, municipal securities dealers, and municipal finance professionals in general from "directly or indirectly" doing

---

[1] "Municipal securities business" is defined for most purposes as excluding issues based on competitive bids. See Rule G-37(g)(vii); see also *SEC Approval Order* at 16 n.41.

anything that would "result in a violation of sections (b) or (c) . . . ."

The petitioner, William B. Blount, is the chairman of the Alabama Democratic Party and a registered broker and dealer of municipal securities. He challenges the SEC's order approving Rule G-37, claiming that each of the three sections of the rule we have described impermissibly infringes his First Amendment rights; that section (d) is, in addition, unconstitutionally vague; and that the rule as a whole violates the Tenth Amendment. The SEC rebuts each of these claims, and the MSRB, as intervenor, raises two defenses not urged by the SEC: that Blount does not have standing under the Exchange Act to pursue his claim and that the rule is not the product of government action and thus cannot violate either the First or Tenth Amendments. We find that Blount has standing to sue and that Rule G-37 is government action. We therefore meet all of Blount's arguments on the merits, though ultimately we reject them and deny the petition for review.

I. Standing and Exhaustion

Neither the Board nor the SEC claims that Blount lacks constitutional or prudential standing, and given his roles as a state party chair and municipal securities dealer, any such claim would be meritless. Instead, the Board points to § 25(c)(1) of the Securities Exchange Act, 15 U.S.C. § 78y(c)(1), which requires that the objections in a petition for review have been "urged before the Commission", and argues that because Blount did not *himself* raise the present objections before the Commission, he is not a "person aggrieved" by the Commission's order within the meaning of § 25(a)(1) of the Securities Exchange Act, 15 U.S.C.

§ 78y(a)(1) (1988). We see nothing in either § 25(c)(1) or § 25(a)(1) that purports to link the two subsections together as the Board suggests. In addition, § 25(c)(1) conspicuously uses the passive voice, saying only that an objection may not be considered by a reviewing court unless it was "urged before the Commission"; it shows no interest in who urged the objection, and is presumably aimed only at assuring that the Commission have had a chance to address claims before being challenged on them in court. Cf. *NRDC v. EPA*, 824 F.2d 1146, 1150-51 (D.C.Cir.1987) (en banc).

The Commission indisputably had the necessary chance. The Board concedes that others raised and the SEC considered the "general constitutional objections to the Rule" that Blount now makes before us. See *SEC Approval Order* at 31-37 (considering constitutional objections). This quite accurate concession reduces the Board to the alternative argument that the SEC did not consider the "specific concerns identified by the Petitioner ... which arise from his particular status and duties as Chairman of the Alabama Democratic Party." While petitioner's activities may represent an unusually good example of the conduct the rule seeks to restrict, the Board does not explain, and we cannot see, how any of the issues the petitioner raises are in any salient way different from the concerns raised and considered during the rulemaking. Blount's claim is therefore not barred by the exhaustion requirement of § 25(c)(1).

II. Government Action

The Board maintains that it is a private organization and that Rule G-37 is a private rule. As such, the Board asserts, the rule cannot be found to violate the First or Tenth Amendments, since the Constitution is "a restraint on

government action, not that of private persons", *CBS v. Democratic Nat'l Comm.*, 412 U.S. 94, 114, 93 S.Ct. 2080, 2092, 36 L.Ed.2d 772 (1973) (plurality opinion).

We put to one side the Board's questionable assertion that it is a purely private organization even though it was created by an act of Congress and directed by Congress to "propose and adopt rules to effect the purposes of [the Exchange Act]" within specified constraints, § 78o-4(b)(2). Cf. *Lebron v. National R.R. Passenger Corp.*, — U.S. —, —, 115 S.Ct. 961, 973, 130 L.Ed.2d 902 (1995) (fact that Amtrak was created by federal law to accomplish federal governmental objectives points toward classification as federal actor). What is critical here is that MSRB Rule G-37 operates not as a private compact among brokers and dealers but as federal law. Under § 15B of the Exchange Act, a broker or dealer may not engage in interstate trade in municipal securities unless he registers under § 15B itself or under § 15 of the Exchange Act. See 15 U.S.C. § 78*o*-4(a)(1) (forbidding dealers to use "instrumentality of interstate commerce" to effect or solicit transactions in municipal securities unless registered as a broker or dealer in accordance with § 15 or § 15B, 15 U.S.C. § 78*o* or § 78*o*-4). If he violates an MSRB rule, he may be sanctioned by revocation or suspension of his license to deal in municipal securities. See *id.* § 78*o*-4(c)(1) (forbidding brokers and dealers from contravening the rules of the MSRB in effecting or soliciting interstate transactions in municipal securities); § 78*o*(b)(4)(D) (authorizing the Commission to suspend or revoke the registration of any broker or dealer who "has willfully violated" or "is unable to comply with" any of the applicable rules, including those of the MSRB); § 78*o*-4(c)(2) (similar authority as to municipal securities dealers). Dealers who violate Rule G-37 and who persist in securities dealing

after any resulting Commission suspension or revocation of their licenses are subject to federal criminal penalties. 15 U.S.C. § 78ff(a) (providing for criminal penalties up to $ 1,000,000 and 10-year imprisonment for natural persons who willfully violate rules). As a government-enforced condition to any participation in a municipal securities career, Rule G-37 constitutes government action of the purest sort.

III. First Amendment Challenge

We turn now to the central issue in this case, petitioner's claim that Rule G-37 violates his First Amendment rights to free speech and free association.

A. Rule G-37 as a restriction of speech

All three sections of Rule G-37 at issue here infringe speech. Giving money is one method of indicating one's devotion to a cause; hence the familiar challenge, "Put your money where your mouth is." The Supreme Court has characterized the campaign contribution as a "symbolic act" that "serves as a general expression of support for the candidate and his views", though noting at the same time that the contribution does not indicate the basis for the support and that a limit on contributions does not "infringe the contributor's freedom to discuss candidates and issues." *Buckley v. Valeo*, 424 U.S. 1, 21, 96 S.Ct. 612, 636, 46 L.Ed.2d 659 (1976) (per curiam); see also *Citizens Against Rent Control v. Berkeley*, 454 U.S. 290, 299, 102 S.Ct. 434, 438-39, 70 L.Ed.2d 492 (1981). Solicitation of campaign funds, the target of sections (c) and (d), is close to the core of protected speech, as it is "characteristically intertwined" with both information and advocacy and essential to the continued flow of both. *Village of Schaumburg v. Citizens*

for a Better Environment, 444 U.S. 620, 632, 100 S.Ct. 826, 833-34, 63 L.Ed.2d 73 (1980).

B. The requisite level of scrutiny

The intensity with which we scrutinize Rule G-37 depends on whether the rule is content-based, eliciting "strict" scrutiny, or content-neutral, eliciting only "intermediate" scrutiny. *Turner Broadcasting Sys., Inc. v. FCC*, — U.S. —, — - —, 114 S.Ct. 2445, 2458-59, 129 L.Ed.2d 497 (1994). The proper categorization of Rule G-37 is not clear-cut. As petitioner points out, under the everyday meaning of the word "content", the rule appears to be content-based, as it restricts only messages that concern one "topic", specifically, financial contributions to political campaigns. Cf., e.g., *McIntyre v. Ohio Elections Comm'n*, — U.S. —, —, 115 S.Ct. 1511, 1529-30, 131 L.Ed.2d 426 (1995); *Consolidated Edison Co. v. Public Serv. Comm'n of New York*, 447 U.S. 530, 537, 100 S.Ct. 2326, 2332-33, 65 L.Ed.2d 319 (1980). But the Supreme Court does not regard a rule's use of subject-based categories as automatically establishing it as content-based. The critical issue is whether the state's justification for the distinction is the "content" of the speech itself or some other concern:

> The principal inquiry in determining content neutrality . . . is whether the government has adopted a regulation of speech because of disagreement with the message it conveys . . . . Government regulation of expressive activity is content neutral so long as it is "*justified* without reference to the content of the regulated speech."

Ward v. Rock Against Racism, 491 U.S. 781, 791, 109 S.Ct. 2746, 2754, 105 L.Ed.2d 661 (1989) (quoting *Clark v. Community for Creative Non-Violence*, 468 U.S. 288, 294, 104 S.Ct. 3065, 3069, 82 L.Ed.2d 221 (1984)) (emphasis added). Compare, e.g., *Turner Broadcasting*, — U.S. at —, 114 S.Ct. at 2467 (content-neutral regulation), and *Renton v. Playtime Theatres, Inc.*, 475 U.S. 41, 106 S.Ct. 925, 89 L.Ed.2d 29 (1986) (same), with *City of Cincinnati v. Discovery Network, Inc.*, — U.S. —, —, 113 S.Ct. 1505, 1517, 123 L.Ed.2d 99 (1993) (content-based regulation), and *Boos v. Barry*, 485 U.S. 312, 108 S.Ct. 1157, 99 L.Ed.2d 333 (1988) (same).[2]

This regulation's goals could well be described as content-neutral. Contributions and solicitation of contributions have two aspects. They may communicate support for a candidate and his ideas, but they may also be used as the cover for what is much like a bribe: a payment that accrues to the private advantage of the official and is intended to induce him to exercise his discretion in the donor's favor, potentially at the expense of the polity he serves. The SEC clearly rested its approval of Rule G-37 on a wish to curtail this latter function. In language tracking that of § 15B of the Exchange Act, 15 U.S.C. § 78*o*-4, it

---

[2] This methodology has come to replace the distinction between speech and conduct regulations originally articulated in *United States v. O'Brien*, 391 U.S. 367, 375, 88 S.Ct. 1673, 1678, 20 L.Ed.2d 672 (1968). See John Hart Ely, "Flag Desecration: A Case Study in the Roles of Categorization and Balancing in First Amendment Analysis", 88 Harv.L.Rev. 1482, 1496 (1975) (noting that the *O'Brien* Court itself adopts purpose test later in its opinion, "abandon[ing] its earlier suggestion that the constitutional answer can be found by examining O'Brien's act").

explained how the limits would, in its judgment, "prevent[] fraudulent and manipulative acts and practices, as well as the appearance of fraud and manipulation", *SEC Approval Order* at 26, perfect the mechanism of a free and open market for municipal securities, *id.* at 29, and "promote just and equitable principles of trade", *id.* at 30. Petitioner himself describes these goals as "nonspeech-related." Petitioner's Br. at 27 n.14.

These purposes are quite different from some of the ones that have triggered strict scrutiny in other cases involving political contributions. In *Buckley v. Valeo*, the interests "served by the Act include[d] restricting the voices of people and interest groups who have money to spend and reducing the overall scope of federal election campaigns", as well as "equalizing the relative ability of all voters to affect electoral outcomes". 424 U.S. at 17, 96 S.Ct. at 634. See also *id.* at 25-26, 96 S.Ct at 637-38 (referring to "ancillary" interest in "serv[ing] to mute the voices of affluent persons and groups in the election process and thereby to equalize the relative ability of all citizens to affect the outcome of elections."); *Austin v. Michigan Chamber of Commerce*, 494 U.S. 652, 660, 110 S.Ct. 1391, 1397, 108 L.Ed.2d 652 (1990) (regulation said to target "corrosive and distorting effects of immense aggregations of wealth that are accumulated with the help of the corporate form and that have little or no correlation to the public's support for the corporation's political ideas"); *FEC v. Massachusetts Citizens for Life, Inc.*, 479 U.S. 238, 263, 107 S.Ct. 616, 630-31, 93 L.Ed.2d 539 (1986) (similar); *FEC v. National Right To Work Committee*, 459 U.S. 197, 207, 103 S.Ct. 552, 559, 74 L.Ed.2d 364 (1982) (similar). Thus the object in *Buckley* and the other campaign finance cases was not only, as here, to prevent *direct* quid pro quos (and the appearance thereof) but more

broadly to reduce the *indirect* impact of wealth on the electoral process, including the *persuasive impact* on both candidates and the public at large of messages communicated by the wealthy in that process. The Commission notes that in keeping with the difference in objectives, Rule G-37 is targeted narrowly to a concrete business relationship between the contributors and the candidates' governmental entities:

> Unlike general campaign financing restrictions, . . . which seek to combat unspecified forms of undue influence and political corruption, [these] conflict of interest provisions, . . . are tied to a contributor's business relationship with governmental entities and are intended to prevent fraud and manipulation.

SEC Approval Order at 34-35.

We are uncertain how much to make of this distinction. In *Buckley* the Court also said that "the primary interest served by the limitations . . . is the prevention of corruption . . . spawned by the real or imagined coercive influence of large financial contributions on candidates' positions and on their actions if elected to office." 424 U.S. at 25, 96 S.Ct. at 638. At no point did the Court suggest that it saw a great divide between efforts to foreclose corruption disguised as campaign contributions and more general efforts to limit the influence of wealth. Moreover, the principle that the Commission claims narrows the rule's purpose—its focus only on "business relations"—is subject in the full-blown modern interest-group state to very broad generalization. The class of people with "business relations to government entities" is plentiful, if we include all government employees; all government contractors; all who

benefit in their business from government activity creating a market for their goods or services (from lawyers specializing in SEC work to suppliers of environmental control technology); all whose businesses benefit from the imposition of regulatory, tax, or tariff restrictions on competitors or potential competitors; all whose income enjoys any kind of tax advantage; and all who are employed by or otherwise economically dependent on firms fitting the description above. The principle could also embrace anyone who (directly or through some group) is seeking to receive any such benefits and anyone seeking to stave off either the cancellation of existing benefits or the imposition of new burdens.

The only other basis for distinguishing the regulatory purposes asserted (and found to be content-based) in *Buckley* and its progeny from those asserted in this case is that the rules in the former cases were intended to safeguard the political process as a whole, whereas here the effort is to safeguard a commercial marketplace. But if the object of extirpating corruption—in the particular form of implicit exchanges between political contributions and politically allocated benefits—is content-based when the focus is on politics, we are uncertain why the object would be content-neutral when the focus is on the allocation of commercial benefits. In every case where a *quid* in the electoral process is being exchanged for a *quo* in a particular market where the government deals, the corruption in the market is simply the flipside of the electoral corruption.

Thus, although the purpose of preventing corrupt bond markets might logically be considered unrelated to the suppression of speech, our difficulty in distinguishing the purposes of this rule from those animating the rules at issue in *Buckley* and *Austin* makes us hesitate to find the rule

content-neutral. If the rule can withstand strict scrutiny there is no need to decide the issue. Accordingly we turn to applying such scrutiny and ask, following *Boos*, 485 U.S. at 321, 108 S.Ct. at 1163-64, and *Sable Communications v. FCC*, 492 U.S. 115, 126, 109 S.Ct. 2829, 2836-37, 106 L.Ed.2d 93 (1989), whether the rule is narrowly tailored to serve a compelling government interest.

C. Application of strict scrutiny

We divide the inquiry into three parts, addressing in turn (1) whether the interests the government proffers in support of the rule are properly characterized as "compelling"; (2) whether the rule effectively advances those interests, i.e., whether the Commission has shown that the ills it claims the rule addresses in fact exist and the rule will materially reduce them, *Turner Broadcasting*, — U.S. at —, 114 S.Ct. at 2470; and (3) whether the rule is narrowly tailored to advance the compelling interests asserted, i.e., whether less restrictive alternatives to the rule would accomplish the government's goals equally or almost equally effectively, *Sable Communications v. FCC*, 492 U.S. at 130-31, 109 S.Ct. at 2838-39. We conclude that the rule meets all three of these requirements.

1. Legitimate and compelling nature of interests asserted

Congress has charged the Commission and the MSRB to create rules

> to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, . . . to remove impediments to and perfect the mechanism of a free and

> open market . . ., and not . . . to permit unfair discrimination between . . . municipal securities brokers, or municipal securities dealers . . . .

15 U.S.C. § 78*o*-4(b)(2)(C). The Commission claims that Rule G-37 supports two interests encompassed within this mandate: (1) protecting investors in municipal bonds from fraud and (2) protecting underwriters of municipal bonds from unfair, corrupt market practices. Both of these interests are not only substantial, see *Turner Broadcasting*, —— U.S. at ——, 114 S.Ct. at 2470 ("[T]he Government's interest in eliminating restraints on fair competition is always substantial . . . .") (citing cases), but, we think, compelling. The Supreme Court has said that "preventing corruption or the appearance of corruption" is "the only legitimate and compelling government interest[] thus far identified for restricting campaign finances." *FEC v. National Conservative PAC*, 470 U.S. 480, 496-97, 105 S.Ct. 1459, 1468-69, 84 L.Ed.2d 455 (1985) (citing the holdings in *Buckley* and *Citizens Against Rent Control*). As we have already noted, in *Buckley* and *Austin* the legislature was interested in clean elections, whereas here the SEC is interested in clean bond markets. Petitioner insists on the importance of this distinction, saying that the latter interest is less compelling than the former. As we see it, however, one of the primary reasons people object to bought elections is that a bought politician tends to make distorted choices, and the public's concern about a particular type of distorted choice (the choice of bond underwriter) does not logically stand on a lower plane than its concern about bought politicians generally.

2. Tendency of the rule to further those interests

Petitioner also maintains that the Commission has failed to provide evidence sufficient to show "that the recited harms are real, not merely conjectural, and that the regulation will in fact alleviate these harms in a direct and material way." *Turner Broadcasting*, — U.S. at —, 114 S.Ct. at 2470.[3] As a threshold matter, petitioner claims there is no support for the Commission's finding that pay-to-play practices are prevalent in the negotiated municipal bond business, because the record contains no evidence of specific instances of quid pro quos. But underwriters' campaign contributions self-evidently create a conflict of interest in state and local officials who have power over municipal securities contracts and a risk that they will award the contracts on the basis of benefit to their campaign chests rather than to the governmental entity. Petitioner himself remarked on national radio that "most likely [state and local officials] are gonna call somebody who has been a political contributor" and, at least in close cases, award contracts to "friends" who have contributed. *Morning Edition* (National

---

[3] We note petitioner's suggestion that the Commission's failure to support its findings with record evidence violates, in addition to the First Amendment, the Securities and Exchange Act, 15 U.S.C. §§ 78y(a)(4), 78y(b)(4) (rules must be supported by "findings . . . as to the facts" and "substantial evidence"), and the Administrative Procedure Act, see 5 U.S.C. § 706(2)(e); *Tex Tin Corp. v. EPA*, 992 F.2d 353, 356 (D.C.Cir.1993) (agency is not "entitled merely to assume" that the practices it seeks to regulate cause the harm it fears). Because the First Amendment requires us to scrutinize the factual basis for the regulation at least as stringently as these statutes, we see no need to address these contentions separately.

Public Radio, June 1, 1994), *available in* LEXIS, News Library, Transcript No. 1358-9. While the risk of corruption is obvious and substantial, actors in this field are presumably shrewd enough to structure their relations rather indirectly—indeed, the phrase "pay to play" suggests that a contribution brings the donor merely a chance to be seriously considered, not the assurance of a contract. As the Court said of quid pro quos for campaign contributions in *Buckley v. Valeo*, "the scope of such pernicious practices can never be reliably ascertained." 424 U.S. at 27, 96 S.Ct. at 638. In any event, the Commission observes that "[s]pecific abuses have been alleged in several state and local governments", *SEC Approval Order* at 8-11, and then cites newspaper clippings from 13 states and the District of Columbia with such headlines as "Kentucky Official Says He Served as Middleman to Solicit Funds", from *The Bond Buyer*, September 7, 1993. Although the record contains only allegations, no smoking gun is needed where, as here, the conflict of interest is apparent, the likelihood of stealth great, and the legislative purpose prophylactic. See *FEC v. National Right to Work Committee*, 459 U.S. 197, 210, 103 S.Ct. 552, 560-61, 74 L.Ed.2d 364 (1982) (Court will not "second-guess a legislative determination as to the need for prophylactic measures where corruption is the evil feared.").

Even assuming the prevalence of quid pro quos, Blount maintains, the Commission has not demonstrated that eliminating such activity advances the asserted interests in protecting investors and promoting just and equitable principles of trade. As to the harm to investors, we tend to share the petitioner's skepticism. The Commission reasoned that pay-to-play practices make underwriters "less likely or competent to perform a reasonable investigation of statements made by the issuer in connection with the offering". *SEC*

Approval Order at 27-28. The Commission points to no data supporting the idea, and it is anything but self-evident. Two interests seem to give the underwriter an incentive to exercise due diligence in investigating municipal issuers: its interest in averting liability for fraud, see *SEC Approval Order* at 26 n. 54 (noting that securities laws impose on underwriters a legal duty to investigate), and its interest in safeguarding its reputation among bond buyers and their representatives. Neither interest would be diminished merely by an underwriter's use of sleazy means to secure the contract. And while an implicit (or even explicit) offer to refrain from investigating thoroughly might well help an underwriter win a negotiated contract, it would help regardless of whether the underwriter also used other means of ingratiating himself with the powers that be.

On the other hand, the link between eliminating pay-to-play practices and the Commission's goals of "perfecting the mechanism of a free and open market" and promoting "just and equitable principles of trade" is self-evident. The Commission explained:

> "Pay to play" practices raise artificial barriers to competition for those firms that either cannot afford or decide not to make political contributions. Moreover, if "pay to play" is the determining factor in the selection of an underwriting syndicate, an official may not necessarily hire the most qualified underwriter for the issue. . . . "Pay to play" practices undermine [just and equitable] principles [of trade] since underwriters working on a particular issuance may be assigned similar roles, and take on equivalent risks, but be

> given different allocations of bonds to sell—resulting in differing profits—based on their political contributions or contacts.

See *SEC Approval Order* at 29-30. Moreover, there appears to be a collective action problem tending to make the misallocation of resources persist. As beneficiaries of the practice, politicians vying for state or local office may be reluctant to stop it legislatively; some, of course, may seek to exploit their rivals' cozy relation with bond dealers as a campaign issue, but if they refuse to enter into similar relations, their campaigns will be financially handicapped. Bond dealers are in a still worse position to initiate reform: individual firms that decline to pay will have less chance to play, and may even be the object of explicit boycott if they do. See "Politicians Are Mobilizing to Derail Ban on Muni Underwriters", *Wall St. J.*, Dec. 27, 1993, at C16 (reporting that Florida Association of Counties called for a boycott of 17 firms that had voluntarily banned political contributions).

Even if the regulation does advance the asserted interests, Blount says, it should be stricken as underinclusive. He points out that the prohibitions on contributions and on solicitation of contributions obviously will not eliminate *all* possible methods by which underwriters may curry favor. Municipal finance professionals remain free, for example, to solicit votes or contribute time and talents to a campaign effort. He also notes that the limitations of Rule G-37 do not apply to chief executive officers of banks with municipal securities departments or subsidiaries.

But a regulation is not fatally underinclusive simply because an alternative regulation, which would restrict *more* speech or the speech of *more* people, could be more effective.

The First Amendment does not require the government to curtail as much speech as may conceivably serve its goals. While the rule chosen must "fit" the asserted goals, *City of Cincinnati*, — U.S. at —, 113 S.Ct. at 1516, it must also, by virtue of the narrow tailoring requirement discussed below, strike an appropriate balance between achieving those goals and protecting constitutional rights. Because the primary purpose of underinclusiveness analysis is simply to "ensure that the proffered state interest actually underlies the law", *Austin*, 494 U.S. at 677, 110 S.Ct. at 1407 (Brennan, J., concurring), a rule is struck for *under*inclusiveness only if it cannot "fairly be said to advance any genuinely substantial governmental interest", *FCC v. League of Women Voters*, 468 U.S. 364, 396, 104 S.Ct. 3106, 3126, 82 L.Ed.2d 278 (1984), because it provides only "ineffective or remote" support for the asserted goals, *id.* (citing *Central Hudson Gas & Elec. Corp. v. Public Serv. Comm'n*, 447 U.S. 557, 564, 100 S.Ct. 2343, 2350, 65 L.Ed.2d 341 (1980)), or "limited incremental" support, *Bolger v. Youngs Drug Prods. Corp.*, 463 U.S. 60, 73, 103 S.Ct. 2875, 2883-84 77 L.Ed.2d 469 (1983). See also *Florida Star v. B.J.F.*, 491 U.S. 524, 109 S.Ct. 2603, 105 L.Ed.2d 443 (1989) (government "must demonstrate its commitment to advancing [its] interest by applying its prohibition evenhandedly. . . . Without more careful and inclusive precautions against alternative forms of [the harm], we cannot conclude that Florida's selective ban . . . satisfactorily accomplishes its stated purpose."). Thus, with regard to First Amendment *under*inclusiveness analysis, neither a perfect nor even the best available fit between means and ends is required.[4]

---

[4] Petitioner tosses into his opening brief a footnote (continued...)

In citing the Commission's failure to cover the CEOs of banks with municipal securities departments as evidence of fatal underinclusiveness, petitioner invokes *Carey v. Brown*, 447 U.S. 455, 471, 100 S.Ct. 2286, 2295-96, 65 L.Ed.2d 263 (1980), which he reads as requiring a "substantial interest" to justify a class's *exemption* from a speech restriction (under an equal protection analysis). Even assuming that that is a correct reading of *Carey*, the decision clearly related to an exemption based on the *content* of the subject's expression (labor matters), see *id.*, and petitioner makes no claim that content played any role whatever in the Commission's exclusion of bank CEOs.

We have already explained why and how we think the provisions of Rule G-37 at issue can be expected materially to advance compelling interests asserted by the Commission. The Commission has explained that the "loopholes" that remain are due to its "sensitivity" to First Amendment

---

[4](...continued)
contending that the Commission's failure to make Rule G-37 applicable to bank officers and bank-controlled political action committees makes for disparate treatment that violates not only the First Amendment but also the due process clause of the *Fifth* Amendment. We find it unnecessary to evaluate this contention. The Fifth Amendment requires only that the government have a rational basis for its distinction, see, e.g., *Vance v. Bradley*, 440 U.S. 93, 109, 99 S.Ct. 939, 948-49, 59 L.Ed.2d 171 (1979) ("Rather than abandoning its primary end completely, or unnecessarily including all federal employees within the means, it drew a line around those groups of employees it thought most generally pertinent to its objective."); and rational-basis review requires, if anything, *less* "mathematical nicety", *id.* at 109, 99 S.Ct. at 948-49, than the First Amendment requires.

concerns; it believes that closing the supposed loopholes would broaden the regulation's scope beyond that "necessary" to accomplish its interests. In other words, the Commission adjudged the risk of corruption in the conduct left unrestrained too remote to warrant restraint. In our view, petitioner has pointed to nothing that calls that judgment into serious question.

3. Narrow tailoring

Blount asserts that Rule G-37 is too broad, arguing that the Commission could have achieved its goal with less restrictive means. Specifically, he claims, it could have confined itself to disclosure and record-keeping requirements (which the Commission instituted in Rule G-37(e) and Rules G-8 and G-9); or, at worst, to those requirements plus the contribution limits of Rule G-37(b). In other words, the Commission probably had no need to curtail *contributions*, Rule G-37(b), and certainly had no need to curtail *solicitation* of contributions, Rule G-37(c).

If the Commission's goals were only to protect the investing public, disclosure and record-keeping requirements might do the job. Informed investors—insofar as they believe contributors are less likely to investigate issuers or more likely to overprice issues—could use the disclosed information to avoid buying bond issues underwritten by campaign contributors. As we pointed out above, however, it is not at all clear that investors are harmed or even perceive themselves to be harmed when underwriters obtain business through shady practices. Thus disclosure would not likely cause market forces to erode "pay to play", and the Commission's other grounds for objecting to the practice would go unmet. Just as the Court in *Buckley v. Valeo* said

that Congress could have found disclosure "only a partial measure", 424 U.S. at 28, 96 S.Ct. at 639, so here the Commission could reasonably find it inadequate. Moreover, without the prohibitions of sections (c) and (d) on soliciting contributions, directly or indirectly, underwriters could easily circumvent the prohibition against direct contributions. Not only would the Commission's purpose of protecting the integrity of the market for underwriting services most certainly "be achieved less effectively", *Ward*, 491 U.S. at 799, 109 S.Ct. at 2758, without the limits on campaign contributions and solicitation, but none of the alternatives presented would be even *almost* equally effective. Cf. *Sable Communications v. FCC*, 492 U.S. at 130-31, 109 S.Ct. at 2838-39 (narrow tailoring requirement not met when the record suggests a less restrictive and possibly "extremely effective" alternative); *Boos*, 485 U.S. at 329, 108 S.Ct. at 1168 (requirement not met when there is evidence that Congress itself "no longer considers this statute necessary" to meet the stated objective and when "a less restrictive alternative is readily available").

Finally, the regulation is "closely drawn" and thus "avoid[s] unnecessary abridgement" of First Amendment rights, *Buckley v. Valeo*, 424 U.S. at 25, 96 S.Ct. at 638. Rule G-37 constrains relations only between the two potential parties to a quid pro quo: the underwriters and their municipal finance employees on the one hand, and officials who might influence the award of negotiated municipal bond underwriting contracts on the other.[5] Even then, the rule

---

[5] The rule does not apply to underwriting business awarded on a competitive basis, that is, "offerings in which the securities are awarded to the underwriting syndicate presenting the best bid (continued...)

restricts a narrow range of their activities for a relatively short period of time. The underwriter is barred from engaging in business with the particular issuer for only two years after it makes a contribution, and it is barred from soliciting contributions only during the time that it is engaged in or seeking business with the issuer associated with the donee. A municipal finance professional may contribute up to $250 per election to each official for whom he or she is entitled to vote, without triggering the business bar. Furthermore, as the Commission interprets the rule, municipal finance professionals are not in any way restricted from engaging in the vast majority of political activities, including making direct expenditures for the expression of their views, giving speeches, soliciting votes, writing books, or appearing at fundraising events. *SEC Approval Order* at 19 ("proposal will not restrict personal volunteer work . . . in political campaigns other than soliciting or coordinating contributions"); *id.* at 36 ("proposal does not restrict uncoordinated independent expenditures"); SEC Release No. 33870 (Apr. 7, 1994) ("*SEC Order Denying Preliminary Stay*") at 8 (ban on solicitation applies only to "explicit solicitations of contributions, and not to generalized

---

[5](...continued)
according to stipulated criteria set forth in the notice of sale." *SEC Approval Order* at 16 n. 41; see also Rule G-37(g)(vii)(A). Although the rule might be interpreted as applying to private placement or advisory service business awarded on a competitive basis, see Rule G-37(g)(vii)(B) and (C), none of the parties mentions this possibility, and petitioner does not contend that he engages in such business. It is therefore unnecessary for us to address the constitutionality of those parts of the rule. See *Burson v. Freeman*, 504 U.S. 191, 210 n. 13, 112 S.Ct. 1846, 1857 n. 13, 119 L.Ed.2d 5 (1992).

solicitations of support for a candidate or his views."); SEC Release No. 34008 (May 4, 1994) ("*SEC Order Denying Stay*") at 12 ("[A]pplicant's concern that the provision could be triggered by inadvertently using the word 'money' in a speech urging support for a candidate, or simply by making a speech of general support at a fund-raising affair, is misplaced. Likewise, his contention that soliciting money for his political party will necessarily trigger the provision is incorrect."); but cf. *id.* at 6 (noting that Blount's complaint is that the rule will prevent him from directing contributed funds to particular state officials, which is normally a duty of the party chairman, and appearing to assume that the rule will have the feared effect).

IV. Vagueness

Petitioner argues that section (d), prohibiting anyone from "directly or indirectly, through or by any other person or means" doing what sections (b) and (c) prohibit, is unconstitutionally vague and in violation of his due process rights under the Fifth Amendment. See, e.g., *Timpinaro v. SEC*, 2 F.3d 453, 460 (D.C.Cir.1993) ("A vague rule denies due process by imposing standards of conduct so indeterminate that it is impossible to ascertain just what will result in sanctions.") (citation and internal quotation marks omitted); see also *Hynes v. Mayor & Council of Oradell*, 425 U.S. 610, 619, 96 S.Ct. 1755, 1760, 48 L.Ed.2d 243 (1976) ("The general test of vagueness applies with particular force in review of laws dealing with speech. . . . [A] man may less be required to act at his peril here, because the free dissemination of ideas may be the loser.") (citation and internal quotation marks omitted).

Although the language of section (d) itself is very broad, the SEC has interpreted it as requiring a showing of culpable intent, that is, a demonstration that the conduct was undertaken "as a means to circumvent" the requirements of (b) and (c). *SEC Approval Order* at 19; see also *SEC Order Denying Stay* at 6 n. 7 (prohibition only affects Blount's family to the degree that "he is directing their contributions, thus seeking to evade the rule's provisions"). The SEC states its "means to circumvent" qualification in general terms. The qualification appears, therefore, to apply not only to such items as contributions made by the broker's or dealer's family members or employees, but also to gifts by a broker to a state or national party committee, made with knowledge that some part of the gift is likely to be transmitted to an official excluded by Rule G-37. In short, according to the SEC, the rule restricts such gifts and contributions only when they are intended as end-runs around the direct contribution limitations.

Moreover, the Commission has substantially reduced any remaining uncertainty about the rule's potential application by providing for informal advance rulings from SEC staff on any proposed course of conduct, *see* 17 CFR §§ 202.1(d) & 202.2. This helps protect underwriters against the sort of risk that the constitutional rule against vagueness seeks to constrain. See *Civil Service Comm'n v. National Ass'n of Letter Carriers*, 413 U.S. 548, 580, 93 S.Ct. 2880, 2897-98, 37 L.Ed.2d 796 (1973) (taking existence of such a procedure into account). And, of course, if the SEC actually brings an enforcement action, the affected party may challenge the particular application of the rule as not reasonably foreseeable under the rule's language. See, e.g., *General Elec. Co. v. EPA*, 53 F.3d 1324, 1330 (D.C.Cir.1995) (agency's interpretation of a rule, though

permissible, may yet be "so far from a reasonable person's understanding" of what the rule might mean that the rule cannot be said to give the "fair notice" necessary for due process).

V. Tenth Amendment Challenge

Finally, petitioner claims that Rule G-37 is an effort to regulate state election campaigns and, as such, usurps the states' power to control their own elections. This contention is meritless. Rule G-37 neither compels the states to regulate private parties, as the Tenth Amendment prohibits, *New York v. United States*, 505 U.S. 144, 112 S.Ct. 2408, 120 L.Ed.2d 120 (1992), nor regulates the states directly, a question on which the Supreme Court's Tenth Amendment jurisprudence "has traveled an unsteady path", *id.* at 160, 112 S.Ct. at 2420. Further, the rule does not have anything resembling the kind of preemptive effect on states' ability to control their own election processes that might be perceived as "destructive of state sovereignty". See *Garcia v. San Antonio Metropolitan Transit Authority*, 469 U.S. 528, 554, 105 S.Ct. 1005, 1019, 83 L.Ed.2d 1016 (1985); cf. *Gregory v. Ashcroft*, 501 U.S. 452, 460-62, 111 S.Ct. 2395, 2401, 115 L.Ed.2d 410 (1991). Blount points to no theory of the Tenth Amendment or the commerce clause under which Congress is disabled from regulating private persons in their conduct of interstate trade in municipal securities, see 15 U.S.C. § 78*o*-4(a)(1), so we need not proceed further. See generally *United States v. Lopez*, — U.S. —, 115 S.Ct. 1624, 131 L.Ed.2d 626 (1995).

* * * * * *

Because Rule G-37 withstands all of Blount's challenges, the petition for review is

Denied.

APPENDIX B

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-33868; File No. SR-MSRB-94-2)

April 7, 1994

Self-Regulatory Organizations: Order Approving Proposed Rule Change by the Municipal Securities Rulemaking Board Relating to Political Contributions and Prohibitions on Municipal Securities Business and Notice of Filing and Order Approving on an Accelerated Basis Amendment No. 1 Relating to the Effective Date and Contribution Date of the Proposed Rule

On January 12, 1994, the Municipal Securities Rulemaking Board ("MSRB") submitted to the Securities and Exchange Commission ("Commission") a proposed rule change (File No. SR-MSRB-94-02) pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934,[1] and Rule 19b-4 thereunder. The MSRB filed the proposal to adopt rules relating to political contributions and prohibitions on municipal securities business. The Commission published notice of the proposal in the Federal Register on January 21, 1994.[2] On February 4, 1994, the Commission extended the comment period for the proposal by 30 days, to March 11, 1994.[3] On March 29, 1994, the MSRB filed an Amendment

---

1 15 U.S.C. § 78s(b)(1).

2 Securities Exchange Act Release No. 33482 (January 14, 1994), 59 FR 3389.

3 Securities Exchange Act Release No. 33583 (February 4, 1994), 59 FR 6320.

to the proposal relating to the proposal's effective date and contribution date.[4]

The Commission received 69 comments letters on the proposed rule change. Twenty-four commentators favor the proposal and 33 oppose the proposal. Several commentators raise concerns without expressly favoring or opposing the proposal. Several commentators that favor the proposal make recommendations to better enable municipal securities dealers to comply with the proposal. The Commission has determined, for the reasons discussed below, to approve the proposed rule change.

I. Executive Summary

The MSRB's proposed rule change relating to political contributions and prohibitions on municipal securities business is intended to address practices known as "pay to play." These practices typically involve payments in the form of political contributions to help finance election campaigns of state or local officials or similar arrangements with these officials. Widespread reports regarding the existence of such

---

[4] As originally submitted, the proposal's prohibitions on municipal securities business would arise from contributions made on or after April 1, 1994. The MSRB filed an amendment to change the April 1, 1994 date to a date 10 days after publication in the Federal Register of the Commission order approving the proposal. The MSRB also amended the proposal to change the effective date of the proposal's disclosure and recordkeeping requirements to a date 10 days after publication of the approval order in the Federal Register. File No. SR-MSRB-94-2, Amendment No. 1 (March 29, 1994).

practices has fueled industry and regulatory concerns. These practices directly affect municipal securities markets by increasing costs borne by issuers, dealers and ultimately investors, by creating artificial barriers to competition, and by undermining underwriter and market integrity. In 1993, state and local governments awarded negotiated underwriting contracts for the sale of more than $250 billion of municipal bonds, approximately 80% of all municipal securities underwritings, to facilitate the construction of schools, highways, hospitals, public housing, bridges, water and sewer systems, and other infrastructure projects needed to serve public needs and spur local and regional economic growth.[5] As of December 31, 1993, private investors, including households and mutual and money market funds, held more than $850 billion in municipal securities, representing approximately 70% of outstanding municipal securities.[6] While it is difficult to quantify the cost of fraudulent, unethical, and manipulative dealer selection practices, at a minimum, these practices substantially undermine the integrity of the municipal securities market. Congress recognized the importance of integrity in municipal securities financing when it directed the formation of the MSRB, as part of the Securities Acts Amendments of 1975, and authorized the MSRB to regulate the conduct of municipal securities dealers to, among other things, prevent fraudulent and manipulative acts and practices, promote just and equitable principles of

---

5 See Public Securities Association, Review of Studies of Competitive and Negotiated Financing of Municipal and Corporate Securities, (March 1994).

6 Board of Governors of the Federal Reserve System, Flow of Funds Accounts, Flows and Outstandings, Fourth Quarter 1993 (March 9, 1994) ("Flow of Funds Accounts").

trade, remove impediments to free and open trade, and protect investors and the public interest.

As the self-regulatory organization ("SRO") charged with primary oversight of municipal securities dealers' activities, the MSRB has proposed a series of measures designed to prevent "pay to play" practices in the awarding of municipal securities business. These measures include a prohibition against municipal securities dealers, conducting certain types of municipal securities business with an issuer if the dealer or affiliated persons, subject to exceptions, made political contributions to officials of the issuer who could influence the awarding of that business. The measures also include separate provisions requiring municipal securities dealers to maintain records and to disclose aggregate information to facilitate compliance and examinations with the goal of promoting investor confidence in the integrity of the municipal securities market. As discussed below, the Commission believes that the proposal is consistent with the Act and will advance the goals of the Act.

II. Background

The market for municipal securities is characterized by great diversity and high volume and comprises an estimated 50,000 issuers including state governments, cities, towns, counties, and special subdivisions, such as special purpose districts and public authorities.[7] There are approximately 1.3 million municipal securities issues outstanding, representing

---

[7] Securities and Exchange Commission, Division of Market Regulation, Staff Report on the Municipal Securities Market, (September 1993) ("Municipal Securities Report") at 1.

over $1.2 trillion in securities.[8] In 1993, 17,000 new issues took place with a record value of $335 billion.[9] As discussed below, negotiated underwritings have become the predominate method of underwriter selection. The MSRB's proposal is designed to address abuses involving political contributions inherent in using negotiated underwriting as a method of underwriter selection.

A. Increasing Use of Negotiated Underwriting

The types of securities generally issued by municipalities include general obligation bonds (secured by the full faith and credit and general taxing power of the issuer), revenue bonds (secured by the revenues of particular project), and conduit bonds (securities issues to finance a project that is to be used in the trade or business of a third party, typically a private corporation or non-profit entity). At one time general obligation bonds were most prevalent. Today, however, most offerings consist of revenue bonds. During the past few years, the municipal bond market also

---

[8] See Flow of Funds Accounts, supra note 6.

[9] This record financing was heavily influences by refundings. Nevertheless, the level of long term new money financing, representing 49% of the financing for the year, reflected continued market growth. In 1993, there were $142 billion of new money long term financings, compared to $81 billion in 1988, a 75% increase. "A decade of Municipal Finance," The Bond Buyer (Jan. 6, 1994) at 24. See also Securities Act Release No. 7049, Securities Exchange Act Release No. 33741 (March 9, 1994), 59 FR 12748, and Securities Exchange Act Release No 33742, (March 9, 1994), 59 FR 12759.

has experience a proliferation of complex derivative products.[10]

Although competitive bidding traditionally has been used for public financing,[11] in recent years negotiated underwritings have become much more common.[12] In 1993,

---

10 Among these are principal and interest strips, pooled municipal investment vehicles, detachable call options, and new variable rate securities.

11 At the time the Exchange Act was enacted, competitive bidding, in one form or another, was the most accepted method of financing used by municipalities and other public entities. L. Loss & J. Seligman, Securities Regulation 343 (1989). In competitive offerings, the issuer decides who will underwrite its bonds based almost entirely on price in response to the issuers "notice of sale." Firms wishing to bid on an issue will include other firms in their syndicates based on their marketing or capital needs and the requirements of the issuer, if any. Some issuers will require the underwriting syndicate to include one or more firms with significant minority participation or specific regional capacity. This requirement usually is stated in the notice of sale. See MSRB, Glossary of Municipal Terms, (1985), definition of "competitive bid" or "competitive bidding."

12 There can be an element of competition present in negotiated deals. In a negotiated offering, the issuer typically distributes a request for proposals ("RFP") to provide underwriting services for either a single issue, or more frequently, for a set period of years. Underwriters that are interested then submit their responses and the issuer will select one or more of the respondents to provide

(continued...)

negotiated underwritings accounted for approximately 80% of all long-term municipal bond offerings.

Competitive bidding offers the public some protection against the exertion of inappropriate influence on public officials by municipal underwriters. When bidding is done

---

[12](...continued)

underwriting services. Issuers commonly select the entire management group in a negotiated offering, and often select most members of the selling group as well. Often an issuer will use the RFP process to "pre-qualify" a pool of underwriters as eligible to provide services and then select specific underwriters on a transaction by transaction basis. Consequently, the RFP process may not purge the selection process of undue influence. Notwithstanding the use of an RFP, issuers may award the municipal securities business according to existing non-merit based relationships with an underwriter.

In a large syndicate, one or more firms will serve as senior syndicate managers or co-managers; a second tier of firms will be designated as managers; the remaining syndicate members are the selling group. The issuer will also designate which of the managers will actually "run the books" and manage the syndicate. The senior managers and managers bear a risk of loss; members of the selling group do not bear this risk. Some issuers may select all the firms and delineate the position of each; others choose several firms as the management group, and give the senior syndicate managers discretion to choose members of the selling group (or name a few selling group members, and allow the senior managers to choose the remainder); still others will choose a senior manager and no others and the manager may or may not form a selling group.

competitively and publicly, there is less possibility of collusion and political patronage. Because the competitive process offers all potential bidders equal opportunity to be awarded the deal, bidders must compete with one another based on the pricing of the issue and the willingness to accept market risk.[13]

In contrast to competitive underwritings, negotiated underwritings present greater risk of abuse in the underwriter selection process.[14] Issuers may become involved not only in selecting the lead underwriter, but also in controlling other provisions of the distribution. Selection may be based on non-meritorious considerations, creating a genuine risk that

---

13 The Government Finance Officers Association ("GFOA") cites three advantages to competitive sales: assurance that the bonds are sold at the lowest cost in the prevailing market; lower gross underwriting spreads than negotiated sales, historically; and promotion of the appearance of an open, fair process. "Taxpayers have greater assurance that the bonds have been awarded at the lowest possible cost, and not for the benefit of underwriting forms engaged in political activities to support elected officials." An Elected Official's Guide to Debt Issuance, Kurish and Tigue, GFOA, Chicago, IL (1993) ("Elected Officials Guide").

14 Negotiated sales do present advantages. GFOA notes three: ability to delegate tasks such as document preparation, sizing and structuring to the underwriter; pre-sale period in which structure may be tailored to investor demand; and flexibility to respond to market conditions. Elected Officials Guide. See also Public Securities Association, Review of Studies of Competitive and Negotiated Financing of Municipal and Corporate Securities, (March 1994).

underwriters will be selected on the basis of political influence rather than the quality of the underwriter's services in distributing the securities.[15]

B. "Pay to Play"

Recent reports regarding "pay to play" have raised concerns about the practices municipal securities dealers employ to obtain municipal securities business. There have been numerous reported instances where registered municipal securities dealers, their employees, and related parties, allegedly have made payments, political contributions, or entered into business ventures with political figures apparently to obtain the underwriting business of municipal securities issuers. Specific abuses have been alleged in several state and local governments including Alabama,[16] California,[17] Colorado[18] the District of Columbia,[19] Florida,[20]

---

15 Regardless of whether an issue is competitive or negotiated, most issuers also employ financial advisers to assist in a bond offering. While some financial advisers are chosen on an issue by issue basis, others are retained to assist the issuer over a period of time. Financial advisers also are paid by the issuer, and their fees may be considered an expense of the offering.

16 "Crying Cronyism" Lawmaker seeks Alabama Ban on Negotiated Deals," The Bond Buyer, (February 7, 1994), at 1.

17 "Curbs Sought on Bond Firm contributions," The Washington Post, (January 14, 1994) at B2.

18 "The Politics of Money," U.S. News and World Report, (September 20, 1993), at 67.

Illinois,[21] Kentucky,[22] Massachusetts,[23] Michigan,[24] New

---

[19](...continued)

[19] "Lazard Pushed D.C. to Arrange Swaps with Merrill Lynch, D.C. Official says," The Bond Buyer, (January 19, 1994), at 1; "Lazard Partner Says Firm Unaware of Ferber's Bid to Share D.C. Fees," The Bond Buyer, (January 20, 1994), at 1; "Cracking the 'Club' that Controls the Muni Bond Market," The Washington Post, (November 21, 1993), at H1.

[20] "The Bond Merchants: Wall Street Makes Millions on Municipal Bonds But Guess Who Pays?" Common Cause Magazine, (October 1993).

[21] "Chicago Confirms Being Subpoenaed by Grand Jury in Ferber Inquiry," The Bond Buyer, (January 13, 1994) at 1; "Illinois Measure Would Restrict Campaign Giving by Bond Dealers," The Bond Buyer, (February 4, 1994), at 1; "Push to Curb Donations Not So Simple," The Chicago Tribune, (November 17, 1993), at 1.

[22] "At Trial, Kentucky's Bill Collins Gets Final Say as Prosecutors Hammer Away at the Gift Piano," The Bond Buyer (October 11, 1993) at 1; "Kentucky Official Says He Served a Middleman to Solicit Funds," The Bond Buyer, September 7, 1993), at 1. Bill Collins is the husband of the former governor of Kentucky, Martha Layne Collins. On October 14, 1993, following a jury trial in the United States District Court for the Eastern District of Kentucky, he was convicted of extortion and conspiracy.

[23] "Treasurer's Office in Massachusetts Confirms Existence of Investigations," The Bond Buyer, (February 7, 1994), at 1; "Massachusetts Bars Merrill From Top Bond-Sale Role," The Wall Street Journal, (February 7, 1994), at C19;

(continued...)

Jersey,[25] New York,[26] Ohio,[27] Oklahoma,[28] and

---

[23](...continued)
"Latest Accusations Leveled Against Ferber Provide New Details on 1990 MIFA Deal"," The Bond Buyer, (December 21, 1993), at 1; "FEDs Subpoena MIFA for Second Time; Bond Documents Since 1982 Sought," The Bond Buyer, (January 27, 1994); "Papers Show New Links Between Ferber, Firm," The Boston Globe, (December 17, 1993), at 1.

[24] "Curbs Sought on Bond Firm Contributions," The Washington Post, (January 14, 1994), at B2.

[25] "Lazard Freres, Merrill Lynch Fee Spitting Livens Debate," The Bond Buyer, (June 25, 1993), at 1; "New Jersey Turnpike, Merrill Lynch at Center of U.S. Attorney Probe," The Bond Buyer, (April 29, 1993), 1; "N.J. Governor Bans Negotiated Underwriting at State Level," The Bond Buyer, (May 5, 1993), at 1; "Turnpike Officials Said Lazard Called the Shots," The Bond Buyer, (May 26, 1993), at 1; "Ferber Investigators Said to Pick Up Pace; Lazard Freres Subpoenaed, Others Wait," The Bond Buyer, (November 23, 1993), at 1.

[26] "Holtzman Dials Direct for Dollars, asking Bankers to Help Pay Off Debt," The Bond Buyer (May 12, 1993), at 1; "Wall Street Executives Appear on List of Fund Raiser for N.Y. Comptroller," The Bond Buyer (October 29, 1993), at 1; "Get Off McCall's Committee," The Bond Buyer (November 1, 1993), at 42; "NYC's Stein Urges Mayor, Comptroller to copy New Jersey, Ban Negotiated Debt," The Bond Buyer, (May 12, 1993), at 1; "N.Y.C. Report Slams Holtzman for Negligence in Fleet Affair,". The Bond Buyer, (September 16, 1993), at 1; "The Trouble with
(continued...)

Wisconsin.[29] The widespread nature of the complaints concerning abuses has received considerable attention from Congress, the Commission, the MSRB, the securities industry, the media, and the public, reflecting concerns regarding the integrity, fairness, and sound operation of the municipal securities market.

C. Regulation of Municipal Securities Underwritings

It appears that "pay to play" practices are considered by many municipal securities dealers to be an ordinary cost

---

[26](...continued)
Consultants, the Market May be Getting Serious About Campaign Contributions, But There's More Ways to Peddle Influence," The Bond Buyer, (November 16, 1993), at 1; "Holtzman Says Loan Didn't Sway Choice of Fleet to Handle New York City Debt," The Bond Buyer, (April 26, 1993), at 1.

[27] "Armacon's Ohio Work A Smith Barney Favor After 1991 Lease Issue Soured in New Jersey," The Bond Buyer, (May 17, 1993), at 1.

[28] "Curbs Sought on Bond Firm Contributions," The Washington Post, (January 14, 1994), at B2; "SEC Investigates Oklahoma Issues for Possible Law Violations," The Bond Buyer, (November 23, 1993), at 1; "SEC Inspects Pike Bond Refinancing," The Daily Oklahoman, (November 19, 1993), at 1; "SEC Asks Agencies in Oklahoma for Data About Bond Issues," The Wall Street Journal, (November 24, 1993), at A5.

[29] "Curbs Sought on Bond Firm Contributions," The Washington Post, (January 14, 1994), at B2.

associated with obtaining municipal underwriting business.[30] The widespread perception of such practices calls into question the integrity of the municipal securities market and the business practices some municipal underwriters utilize in order to obtain underwriting contracts. Several reports have suggested that the greatest cost of improper contributions is the cost to investors, taxpayers, and the public at large.[31]

As a result of reports alleging improper payments regarding the New Jersey Turnpike refunding, in May 1993, Congress requested the Commission, the MSRB, and the National Association of Securities Dealers ("NASD") to review the adequacy of regulation and oversight of the municipal securities market.[32] This culminated in the Division's Municipal Securities Report,[33] and Congressional

---

30 "Illegal Payments Mar the Muni Market," The Wall Street Journal, (May 5, 1993), at C1.

31 "Bond Buyers' Gains, Taxpayers' Loss," New York Times, (September 5, 1993), at 11; "The Trouble with Munis, the Market is Sound, But Abuses Hurt Both Investors and Taxpayers," Business Week, (September 6, 1993), at 44.

32 Letter from the Honorable John D. Dingell, Chairman, Committee on Energy and Commerce, United States House of Representative, and The Honorable Edward J. Markey, Chairman, Subcommittee on Energy and Commerce, United States House of Representatives, to Mary L. Schapiro, Acting Chairman, Commission, Christopher A. Taylor, Executive Director, MSRB, and Joseph R. Hardiman, President and Chief Executive Officer, NASD (May 24, 1993).

33 Supra note 7.

hearings on the municipal securities market held on September 9, 1993. The Municipal Securities Report recommended that "pay to play" contributions be addressed promptly.[34] The Staff stated that an MSRB proposal to require disclosure of political contributions and limiting campaign contributions for the purpose of obtaining underwriting business represented a positive first step to address the misuse of political contributions.[35]

The MSRB's efforts to examine the role of political contributions in the underwriting process pre-date recent public interest in the issue. In August 1991, the MSRB published a notice expressing concern that the process of selecting an underwriting team should not be influenced by political contributions, and encouraged underwriters, and state and local governments to maintain the integrity of the underwriter selection process.[36] In May 1993, the MSRB issued a press release noting continued concern by the MSRB,

---

34 The Commission's Chairman Arthur Levitt testified that, "[w]hile the Commission remains confident of the strength and effectiveness of the municipal securities market, we also share the Subcommittee's concern that investor confidence in its integrity may have been impaired as a result of recent serious allegations of abusive practices." Testimony of Arthur Levitt, Chairman, Commission, Concerning the State of the Municipal Securities Market, Before the Subcommittee on Telecommunications and Finance, Committee on Energy and Commerce, United States House of Representatives (September 9, 1993).

35 Municipal Securities Report, supra note 7, at 33.

36 See MSRB Report, Vol. 11, No. 3, (September 1991) at 11.

industry members, and others regarding political contributions.[37]

In August 1993, the MSRB published for comment draft Rule G-37 ("August 1993 draft rule").[38] Although the majority of commentators supported the MSRB proposal, none gave unqualified support. After considering the commentators' concerns and suggestions at its November and December 1993 meetings, the MSRB proposed the instant rule change.

Some state officials and politicians have advocated or introduced legislation aimed at abuse resulting from political contributions and have made attempts to reform the municipal securities underwriter selection process.[39] Voluntary industry

---

37 See MSRB Reports, Vol. 13, No. 3, (June 1993) at 15.

38 The draft proposal would have (1) prohibited brokers, dealers and municipal securities dealers and their associated persons from making political contributions, directly or indirectly, to officials of issuers for the purpose of obtaining or retaining municipal securities business, and (2) required dealers and their associated persons to disclose, for a four-year period, all political contributions to officials of such issuers with whom they have done business.

39 E.g., House No, 1824, The Commonwealth of Massachusetts (a recently introduced bill to prohibit political contributions by investment bankers and bond counsel); The Commonwealth of Massachusetts Joint Statement on Debt Policy (issued to "[r]eaffirm and extend the statutory presumption that all Commonwealth Debt . . . shall be issued on a competitive, sealed-bid (lowest true (continued...)

efforts also are underway to reduce the presence of inappropriate political influence peddling. On October 18, 1993, seventeen municipal securities dealers agreed to adopt a "Statement of Initiative," providing that political contributions made, in any manner, for the purpose of influencing the awarding of municipal finance business should

---

[39](...continued)

interest cost) basis and establish standards for rebutting that presumption . . .; [e]stablish a basic framework for the establishment of procurement process for the selection of underwriters, financial advisors and attorneys . . .; [and] [f]urther the practice of requiring disclosure by underwriters, financial advisors and attorneys which fosters the elimination of conflicts of interest among those which serve the Commonwealth . . . in . . . issuances of debt."). The Commonwealth of Massachusetts Treasury Department (October 27, 1993).

See also "Crying Cronyism, Lawmaker Seeks Alabama Ban on Negotiated Deals," The Bond Buyer, (February 7, 1994), at 1; "Curbs Sought on Bond Firm Contributions," The Washington Post, (January 14, 1994), at B2; "Shapiro of Maine Seeks MSRB Ban on Political Contributions from Bond Firms," The Bond Buyer, (May 14, 1993), at 1; N.J. Governor Bans Negotiated Underwriting at State Level," The Bond Buyer, (May 5, 1993), at 1; "Following SEC, Texas Authority Seeks Disclosure on Political Gifts," The Bond Buyer, (June 23, 1993), at 1; "Massachusetts Bars Merrill From Top Bond Sale Role," The Wall Street Journal, (February 7, 1994), at C19; "Municipal Bond Group Urges End to Being Solicited," The Wall Street Journal, (October 8, 1993), at C1.

be prohibited. To date, over 50 firms have agreed to adhere to the Statement of Initiative.[40]

While the Commission views the voluntary efforts of those firms adhering to the Statement of Initiative as laudable, these actions represent only a first step. The MSRB's proposed rule change marks a second step: industry-wide reform intended to respond to the detrimental effects of conflicts of interest.

III. Description

The proposed rule change would establish industry-wide restrictions and requirements aimed at preventing fraudulent and manipulative practices, promoting just and equitable principles of trade, removing impediments to free and open trade, and protecting investors and the public interest. The MSRB's proposal is intended to address the real as well as perceived abuses resulting from "pay to play" practices in the municipal securities market. The proposal is a comprehensive scheme composed of several separate requirements affecting municipal securities dealers, including limitations on business activities triggered by political contributions, limitations on solicitation and coordination of

---

40 Some state and local officials have stated their intention to boycott those firms that voluntarily stop political contributions. The Florida Association of Counties, for example, called for its members to boycott seventeen securities firms that have voluntarily banned political contributions citing these firms' endorsement of "public policy damaging rules." See "Politicians are Mobilizing to Derail Ban on Muni Underwriters' Campaign Gifts," The Wall Street Journal, (December 27, 1993), at C16.

political contributions, and dealer recordkeeping and disclosure.

A. Rule G-37—"Pay to Play" Restrictions

1. Business Disqualification Provision. Proposed rule G-37 will prohibit brokers, dealers and municipal securities dealers ("dealers") from engaging in municipal securities business with an issuer within two years after proscribed contributions made by (1) the dealer, (2) any municipal finance professional associated with the dealer or (3) any political action committee ("PAC") controlled by the dealer or any such associated municipal finance professional, to an official of the issuer who can, directly or indirectly, influence the awarding of municipal securities business "Municipal securities business" includes certain dealer activities such as the purchase of primary offering of municipal securities from the issuer on other than a competitive bid basis (i.e., acting as a managing underwriter or as a syndicate member in negotiated underwritings), and acting as a financial advisor, consultant, placement agent, or negotiated remarketing agent.[41] The proposal defines an "official of an issuer" as any incumbent, candidate or successful candidate for elective office of the issuer, which office is directly or indirectly responsible for, or can influence

---

[41] The proposed rule does not apply to competitive bids, i.e., offerings in which the securities are awarded to the underwriting syndicate presenting the best bid according to stipulated criteria set forth in the notice of sale. See Glossary of Municipal Terms, supra note 11. Obviously, there is potential for abuse in determining the criteria y which eligibility is determined. If such abuse occurs, we would expect the MSRB to respond appropriately.

the outcome of, the hiring of a dealer for municipal securities business. This includes any issuer official, incumbent or candidate (or successful candidate) who has influence over the awarding of municipal securities business. "Contributions" include any gift, subscription, loan, advance, or deposit of money or anything of value made: (1) for the purpose of influencing any election of any official of a municipal securities issuer for federal, state,[42] or local office; (2) for payment or reduction of debt incurred in connection with any election; or (3) for transition or inaugural expenses incurred by the successful candidate for state or local office.

Thus, contributions to certain state-wide executive or legislative officials will affect the eligibility of the firm to engage in municipal securities business.[43] The proposal applies to contributions made on or after [insert date 10 days after publication in the Federal Register].[44]

The proposal's disqualification provision also would be triggered by contributions from employees of dealers, defined as "municipal finance professionals," are primarily engaged in municipal securities business. The proposal exempts contributions made by municipal finance

---

42 The term "state" is defined in Section 3(a)(16) of the Act to mean any sate of the United States, the District of Columbia, Puerto Rico, the Virgin Islands, or any other possession of the United States.

43 For example, governors will be included under the proposal's definition of official of an issuer.

44 File No. SR-MSRB-94-2, Amendment No. 1 (March 29, 1994). See supra note 4.

professionals of $250 or less per election to each official for whom the term "municipal finance professional" to mean: (1) any associated person primarily engaged in municipal securities representative activities, as defined in rule G-3(a)(i),[45] (2) any associated person who solicits municipal securities business; (3) any direct supervisor of such persons up through and including, in the case of a dealer other than a bank dealer, the chief executive officer or similarly situated official and, in the case of a bank dealer, the officer or officers designated by the board of directors of the bank as responsible for the day-to-day conduct of the bank's municipal securities dealer activities, as required pursuant to rule G-1(a); or (4) any member of the dealer executive or management committee or similarly situated officials, if any (or, in the case of a bank dealer, similarly situated officials in

---

[45] Rule G-3(a)(i) defines the term "municipal securities representative" as a person associate with a dealer, other than a person whose functions are solely clerical or ministerial, whose activities include one or more of the following: (A) underwriting, trading or sales of municipal securities; (B) financial advisory or consultant services for issuers in connection with the issuance of municipal securities; (C) research or investment advice with respect to municipal securities; or (D) any other activities which involve communication, directly or indirectly, with public investors in municipal securities; provided, however, that the activities enumerated in subparagraphs (C) and (D) are limited to such activities as they relate to the activities enumerated in subparagraphs (A) and (B).

the separately identifiable department or division of the bank, as defined in rule G-1).[46]

Family members are not specifically included within the definition of municipal finance professional. The proposal, however, prohibits a dealer and any municipal finance professional from doing any act indirectly which would result in a violation of the proposed rule if done directly by the dealer or municipal finance professional. This is intended to prevent dealers from funnelling funds or payments through other persons or entities to circumvent the proposal's requirements. For example, a dealer would violate the proposal if it does business with an issuer after contributions were made to an issuer official from or by associated persons, family members of associated persons, consultants, lobbyist, attorneys, other dealer affiliates, their employees or PACs, or other persons of entities as a means to circumvent the rule. A dealer also would violate the rule by doing business with an issuer after providing money to any person or entity when the dealer knows that the money will be given to an official of an issuer who could not receive the contribution directly from the dealer without triggering the rule's prohibition on business.

The proposal will not restrict personal volunteer work by municipal finance professionals in political campaigns other than soliciting or coordinating contributions. However,

---

[46] The proposal's prohibition on business would result if a municipal finance professional associated with the dealer made the contribution before becoming associated with the dealer, (the two year ban on business applies to both the current and prior employees of the municipal finance professional).

if resources of the dealer are used or expenses are incurred by the municipal finance professional in personal volunteer work, the value of the resources or expenses must be included in determining whether the dealer is restricted from future negotiated underwritings involving that issuer or whether the municipal finance professional exceeded the $250 limitation.

2. Solicitation Restriction. The proposal also will prohibit dealers from soliciting contributions on behalf of officials of issuers with which the dealer is engaging or seeking to engage in municipal securities business.[47] This will prevent dealers from engaging in municipal securities business with issuers if they engage in any kind of fund-raising activities for officials of the issuers that may influence the underwriter selection process. This prohibition on solicitation and coordination also applies to municipal finance professionals. The proposal prohibits municipal finance professionals from soliciting contributions to an official of an issuer with which the dealer engages or is seeking to engage in municipal securities business and from coordinating contributions.

B. Disclosure and Recordkeeping

The proposal would establish disclosure and recordkeeping requirements to facilitate enforcement of rule G-37's "pay to play" restrictions and, independently, to function as a public disclosure mechanism to enhance the

---

[47] The term "seeking to engage in municipal securities business" means dealer activities including responding to requests for proposal, making presentations of public finance capabilities, and other soliciting of business with issuer officials.

integrity of and public confidence in municipal securities underwriting. Thus, although the disclosure and recordkeeping provisions will generally supplement the "pay to play" restrictions, the purposes served by these provisions are distinct from, and not dependent on, the business disqualification or solicitation restriction provisions.

1. Rule G-37. Proposed rule G-37 will require dealers to disclose to the MSRB on Form G-37 certain information abut political contributions, as well as other summary information, to facilitate public scrutiny of political contributions in the context of the municipal securities business of a dealer. Contributions to be reported include those to officials of issuers and political parties of states and political subdivisions made by the dealer, any municipal finance professional any executive officer and any PAC controlled by the dealer or by any municipal financial professional.[48] Only contributions over $250 by municipal finance professionals and executive officers are required to be disclosed. The proposal does not require dealers to disclose the names of individual municipal finance professionals and executive officer.

The proposal requires that dealers report on Form G-37 by state: (1) the name and title, (including any city/county/state or other political subdivision) of each official of an issuer and political party receiving contributions; (2) the

---

[48] The proposal does not require dealers to maintain a list of contributions by other employees, affiliated companies and their employees, spouses of municipal finance professionals, or any other person or entity unless the contributions were directed by persons or entities subject to the proposal.

total number and dollar amount of contributions made by the dealer, dealer controlled PACs, and associated municipal finance professionals, and (3) other identifying information as required by Form G-37. Dealers also will be required to disclose issuers with which the dealer has engaged in municipal securities business during the reporting period, along with the type of municipal securities business and the name, company, role and compensation arrangement of any person employed by the dealer to obtain or retain municipal securities business from the issuers. The reports are required to be made on Form G-37 and to be submitted to the MSRB in accordance with rule G-37 filing procedures, quarterly, by dates determined by the MSRB.

The MSRB will include information reported on Form G-37 in its electronic library system, the Municipal Securities Information Library (MSIL). The MSRB will develop appropriate filing procedures to allow for public access to the information, as well as indexing, and record storage.

2. Rules G-8 and G-9. The proposal will amend rules G-8 and G-9 on recordkeeping and record retention regarding political contributions. The proposed amendment to rule G-8 will require a dealer to maintain a list of: (1) names, titles, city/county and state of residence of all associated municipal finance professionals; (2) names, titles, city/county and state of residence of all executive officers of the dealer; (3) the states in which the dealer is engaging or is seeking to engage in municipal securities business; (4) every issuer with which municipal securities business has been conducted during the current year, as well as the previous two years and, where applicable, the name, company, role and compensation arrangement of any person employed by the dealer to obtain or retain municipal securities business with the issuer; and (5)

all contributions, direct or indirect, to officials of issuers and to political parties of states and political subdivisions made by the dealer, each dealer-controlled PAC, and each associated municipal finance professional and executive officer.[49] The records required pursuant to the proposal apply to contributions made or business engaged in beginning [insert date 10 days after publication in the Federal Register].[50]

The proposal does not require the dealer to maintain a last of contributions by its municipal finance professionals or executive officers that are made: (1) to officials for whom the person is entitled to vote, provided such contributions do not exceed $250 to each issuer official, per election; or (2) to political parties for the state and political subdivision in which the person is entitled to vote, provided the contributions do not exceed $250 per party, per year. The proposal also does not require dealers to maintain a list of contributions by any other employees, affiliate companies and their employees, spouses of covered employees, or any other person or entity unless the contributions were directed by persons or entities subject to proposed rule G-37.

The proposed amendment to rule G-9 requires dealers to maintain, for a six-year period, those records required to be made pursuant to the proposed amendment to rule G-8.

---

[49] Dealers will be required to record, per contribution, the identity of the contributor and the recipient and the amount of the contribution.

[50] File No. SR-MSRB-94-2, Amendment No. 1 (March 29, 1994). See supra note 4.

IV. Summary of Comments

The Commission received 69 comment letters on the proposal. A separate summary of comments was prepared and is available in the public file. The Discussion section of this order addresses specific issues addressed by the commentators.

V. Discussion

The MSRB's rule proposal seeks to end "pay to play" abuses in municipal securities underwritings. The MSRB has determined that the most effective means of accomplishing this goal is through adoption of several provisions consisting, as described above, of a business disqualification provision, a solicitation restriction and disclosure and recordkeeping requirements. These provisions reflect well-established methods for dealing with conflicts of interest and other instances where improper influence is used to secure an unmerited benefit.

The Commission believes that the MSRB's proposal is tailored to accomplish its stated goals with minimal disruption in the municipal securities industry and the state and local political process to which that industry is linked. The commission agrees with the MSRB that its proposal represents an appropriate response to a compelling problem and, therefore, has determined to approve the proposed rule change.

A. Statutory Standard

The proposed rule change is consistent with the requirements of the Act, and in particular, with Sections

158(b) (2) (C) and (G) of the Act.[51] Section 158(b) (2) (C) authorizes the MSRB to adopt rules designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating transactions in municipal securities, to remove impediments to and perfect the mechanism of a free and open market in municipal securities and, in general, to protect investors and the public interest. Section 158(b) (2)16) authorizes the MSRB to adopt rules that prescribe the records to be made and kept by municipal securities dealers and the periods for which such records shall be preserved. Because the MSRB's rules are to be preventive in nature, Section 15B defines the scope of the MSRB's authority in terms of purposes rather than subject matters. This authority provides the MSRB with flexibility to deal with future problems in the municipal securities industry.[52] Thus, Section 15B provides the MSRB

---

51 Sections 15B(b)(2)(C), (G); [15 U.S.C. §§ 78o-4(b)(2)(C), (G)].

52 The legislative history of the 1975 Acts Amendments adopting Section 15B indicated that Congress did not believe it would be desirable to restrict the MSRB's authority by a specific enumeration of subject matters. "The ingenuity of the financial community and the impossibility of anticipating all future circumstances are obvious reasons for allowing the [MSRB] a measure of flexibility in laying down the rules of the municipal securities industry." S. Rep. No. 75, Securities Exchange Act of 1975: Report of the Committee on Banking, Housing, and Urban Affairs, to Accompany S. 249, 94 Cong., 2d Sess. 43 ("Senate Report") at 225.

broad rulemaking authority to implement its enumerated purposes.

1. Prevent Fraudulent and Manipulative Acts and Practices. The Commission and the MSRB have a significant interest in preventing fraudulent and manipulative acts and practices, as well as the appearance of fraud and manipulation, in the municipal securities market. One of the principal goals of Section 15B is to address threats to the integrity of the municipal securities market.[53] Underwriters perform essential functions in offerings by structuring the offering and preparing disclosure documents that form the basis of marketing the offering to the public.[54] If underwriter selection is swayed by political contributions or

---

53 "S. 249 would provide, through amendment of the Exchange Act, a comprehensive pattern for the regulation of brokers, dealers, and banks trading municipal securities. The Committee feels that the lack of federal regulation . . . represents a serious threat to the integrity of the capital-raising system upon which local governments rely to finance their efforts." Senate Report at 215, 16.

54 In the proposing and adopting releases for Rule 15c2-12, the Commission set forth its interpretation of the obligation of municipal securities underwriters under the antifraud provisions of the federal securities laws. The interpretation discussed the duty of underwriters to the investing public to have a reasonable basis for recommending any municipal securities, and their responsibility, in fulfilling that obligation, to review in a professional manner the accuracy of statements made in connection with the offering. Securities Exchange Act Release No. 26100 (September 28, 1988), 53 FR 37778; Securities Exchange Act Release No. 26985 (July 10, 1989), 54 FR 28799.

influence, underwriters may be chosen based on their history of contributions or political contacts, rather than their expertise or competence.

Several commentators contend that reports of abuse are unsubstantiated,[55] or view the issue as one of voter confidence and campaign reform, rather than investor

---

55 For example, one commentator states that "there have been relatively few reported instances of improper behavior in the market where approximately 15,000 issues are sold each year involving thousands of public officials.... Many of the high-profile cases of improper behavior that have been cited as evidence of corrupt practices caused by campaign giving are either illegal already or would not be affected by a prohibition on political contributions." Letter from Jeffrey I. Esser, Executive Director, Government Finance Officers Association, to Jonathan Katz, Secretary, Commission (March 10, 1994). See also letter from Donald J. Borut, Executive Director, National League of Cities, to Jonathan Katz, Secretary, Commission (February 7, 1994); letter from Harlan E. Boyles, State Treasurer, North Carolina, to Arthur Levitt, Chairman, Commission (January 28, 1994).

Several commentators state that the majority of political contributions by municipal securities dealers and their associated persons are given for legitimate purposes and are unrelated to the selection of municipal securities underwriters. E.g., letter from Jeffrey I. Esser, Executive Director, Government Finance Officers Association, to Jonathan Katz, Secretary, Commission (March 10, 1994).

protection.[56] The Commission believes, however that "pay to play" practices may damage the municipal securities market in several ways. If political influence is the determinative factor in the choice of municipal securities dealers as underwriters in an offering, the underwriter selected may be less likely or competent to perform a reasonable investigation of statements made by the issuer in connection with the offering.[57] A decrease in the credit quality of the issue after it has been sold could have a significant adverse impact on investors, and the underwriter's investigation might reveal information that bears directly on the issuer's future ability to meet interest and principal payment obligations on a timely basis.

"Pay to play" also undermines the integrity of municipal securities underwriting. The mere perception of political influence in underwriter selection diminishes investor confidence in an underwriter's willingness to faithfully fulfill its obligations to the investing public. The Statement of Initiative itself attests to the prevalence of industry concerns regarding the effects of these practices on the integrity of the municipal securities market and underwriters.

---

56 E.g., letter from Jeffrey I. Esser, Executive Director, Government Finance Officers Association, to Jonathan Katz, Secretary, Commission, (March 10, 1994). The Government Finance Officers Association "believes that any improper relationship is properly a voter, taxpayer and ratepayer concern because of the potential impact such a relationship could have on the cost of the financing."

57 See supra note 54.

The perception of conflicts of interest is also damaging to investor confidence. Although some commentators suggest that investor confidence has not been affected by "pay to play" practices,[58] the Commission, relying on its own expertise as well as the judgment of the MSRB, believes that the widespread reports of abuse adversely affect investor confidence and that the MSRB's proposal will help to strengthen the integrity of the underwriting process and will help to restore and maintain investor confidence.[59]

---

[58] One commentator states that "[t]o my knowledge the practice of campaign contributions made by participants of the municipal securities industry has not resulted in bond defaults or other value losses that directly affect individual investors. Even the most egregious abuses documented in the national press have not resulted in investor losses in either primary offerings or in the secondary markets." Letter from Kenneth L. Rust, Debt Manager, Mayor, City of Portland, Oregon, to Jonathan Katz, Secretary, Commission (February 28, 1994)

[59] Because, as discussed herein, regulation of political contributions by municipal securities dealers and municipal securities professionals is intended to enhance the fairness and efficiency of the municipal securities market, it is directly related to the purposes of the Act. Some commentators raise objections to the proposal on federalism grounds. E.g., letter from David Norcross, General Counsel, Republican National Committee to Jonathan Katz, Secretary, Commission (March 11, 1994). Although the MSRB's proposal will have some effect on political fundraising activities of candidates for certain state

(continued...)

2. Perfect the Mechanism of Free and Open Market. As discussed above, several reports have indicated that "pay to play" practices are considered by many municipal securities underwriters to be an ordinary cost of doing business. Because of great competitive pressures to obtain business, municipal securities firms and the offering process are susceptible to abusive political contribution practices. "Pay to play" practices raise artificial barriers to competition for those firms that either cannot afford or decide not to make political contributions. Moreover, if "pay to play" is the determining factor in the selection of an underwriting syndicate, an official may not necessarily hire the most qualified underwriter for the issue. The proposal makes clear to municipal securities dealers and to officials of issuers that "pay to play" practices should no longer be employed to obtain municipal securities business. The proposal will further merit-based competition between municipal securities dealers and, thus, will remove impediments to and perfect the mechanism of a free and open market for municipal securities.

---

[59](...continued)

and local offices, these effects do not transgress any limits on federal authority over state political activities. The MSRB's rules are directed at municipal securities dealers and municipal finance professionals and do not regulate the conduct of state officials. Cf. New York v. United States, 112 S. Ct. 2408 (1992). As such, the proposed rule change falls within the legitimate scope of the MSRB's congressionally-mandated jurisdiction regarding the conduct of municipal securities participants, notwithstanding any incidental effects on state elections.

3. Promote Just and Equitable Principles of Trade. The proposal will promote just and equitable principles of trade. One of the primary principles of Section 15B is to raise the level of conduct in the municipal securities industry.[60] "Pay to play" practices undermine these principles since underwriters working on a particular issuance may be assigned similar roles, and take on equivalent risks, but be given different allocations of bonds to sell—resulting in differing profits—based on their political contributions or contacts. The MSRB, under the Commission's supervision, was given primary rulemaking authority to regulate the conduct of municipal securities dealers by adopting rules to promote just and equitable principals of trade. In particular, the MSRB is obligated to assure that municipal securities dealers observe high professional standards in their activities with the public. The Statement of Initiative demonstrates the significance with which municipal securities dealers address reports of abuse in the municipal securities market. The proposal will extend the goals of the Statement of Initiative to all municipal securities dealers attempting to obtain municipal securities business.

4. Foster Cooperation and Coordination in Regulating Municipal Securities Transactions. The proposal will foster cooperation and coordination with persons engaged in regulating transactions in municipal securities. The proposal's disclosure and recordkeeping requirements will aid the Commission, the MSRB, and the NASD to oversee enforcement of and dealer compliance with the proposal.

---

[60] See Senate Report at 224, 25. Because the MSRB is an SRO for municipal securities dealers, it is an appropriate body to establish just and equitable principles of trade.

5. Records and Record Retention. The proposal's record and record retention requirements are consistent with Section 158(b) (2) (G) of the Act which authorizes the MSRB to adopt rules that prescribe the records to be made and kept by municipal securities dealers and the periods for which such records shall be preserved. As discussed above, the proposal's record and record retention requirements, along with its prohibitions on municipal securities business, are designed to prevent "pay to play" practices in the awarding of municipal securities business.

B. First Amendment Guarantee of Free Speech

Several commentators believe that the proposal's prohibitions on political contributions impermissibly infringe on the First Amendment guarantees of freedom of speech and association,[61] and constitutional guarantees of equal

---

[61] One commentator, for example, states that "it is an infringement on individual first amendment rights to prohibit any person's financial support of a candidate because it is 'presumed' the contributor is involved in some 'pay to play' scheme." Letter from Michael E. Arrington, Chairman, Bi-County Sub-Committee, Maryland House of Delegates, to Arthur Levitt, Chairman, Commission (December 22, 1993). See e.g. letter from Jeffrey L. Esser, Executive Director, Government Finance Officers Association, to Jonathan Katz, Secretary, Commission (March 10, 1994); letter from Marshall Bennett, President, and Bob Holden, Ethics Task Force, National Association of State Treasurers, to Jonathan Katz, Secretary, Commission (March 11, 1994); letter from David Norcross, General Counsel, Republican National Committee to Jonathan Katz, Secretary, Commission (continued...)

protection.[62] These commentators believe that although municipal bond business should not be a "pay back" for political contributions, the proposal restricts the ability of municipal securities underwriters and their employees to demonstrate support for state and local officials.[63]

---

[61](...continued)
(March 11, 1994).

[62] One commentator, for example, states that "Rule G-37 fails to treat similarly-situated individuals in a like manner by classifying municipal broker-dealers and municipal finance professionals as the only persons subject to the burdens of the rule while other similarly situated persons, such as consultants and non-registered municipal finance professionals, are not subject to the same burden." Letter from Raymond J. McClendon, Vice-Chairman and Chief Operating Officer, Pryor, McClendon, Counts & Co., Inc., to Margaret H. McFarland, Deputy Secretary, Commission (March 9, 1994).

[63] See e.g., letter from Donald J. Borut, Executive Director, National League of Cities, to Jonathan Katz, Secretary, Commission (February 7, 1994); letter from Michael E. Arrington, Chairman, Bi-County Sub-Committee, Maryland House of Delegates, to Arthur Levitt, Chairman, Commission (December 22, 1993); letter from Raymond J. McClendon, Vice-Chairman and Chief Operating Officer, Pryor, McClendon, Counts & Co., Inc., to Margaret H. McFarland, Deputy Secretary, Commission (March 9, 1994).

In light of the Commission's approval and enforcement of MSRB's rules, the Commission is sensitive to and has carefully considered these constitutional concerns in reviewing the proposed rule change.[64] The Commission acknowledges that the business disqualification provision may affect the propensity of municipal securities underwriters to make political contributions. Although political contributions involve both speech and associational rights protected by the First Amendment, a "limitation on the amount that any one person or group may contribute to a candidate or political committee entails only a marginal restriction upon the contributor's ability to engage in free communication." [65] Even a significant interference with rights protected by the First Amendment may be justified by a sufficiently compelling government interest so long as the interference is closely drawn to avoid unnecessary abridgment of thou protected rights.[66]

---

[64] Several commentators disagree with the MSRB's conclusion that it is not a state actor for purposes of constitutional protections. See letter from William H. Ellis, President and Chief Operating Officer, Piper Jaffray Inc., to Jonathan Katz, Secretary, Commission (March 10, 1994); letter from Marshall Bennett, President, and Bob Holden, Ethics Task Force, National Association of State Treasurers, to Jonathan Katz, Secretary, Commission (March 11, 1994); letter from Raymond J. McClendon, Vice-Chairman and Chief Operating Officer, Pryor, McClendon, Counts & Co., Inc., to Margaret H. McFarland, Deputy Secretary, Commission (March 9, 1994).

[65] Buckley v. Valeo, 424 U.S. 1, 20 (1976).

[66] Id. at 25.

Prevention of fraud and manipulation and the appearance of fraud and manipulation are compelling government interests. The MSRB's proposal is in the context of a closely regulated industry and is directly relevant to the concerns of the regulatory scheme. The MSRB's interests in seeking approval of the proposed rule change—the eradication of "pay to play" practices and other arrangements—are precisely the kind of interests which have been deemed sufficiently compelling to justify restrictions on political contributions.[67] As discussed above, "pay to play" arrangements can have detrimental effects on the municipal securities markets; the widespread perception that these practices are commonplace undermines the integrity of the market and diminishes investor confidence. Moreover, the restrictions inherent in the MSRB's proposed rule change are in the nature of conflict of interest limitations which are

---

[67] For example, Florida's Division of Bond Finance prohibits the awarding of municipal securities business to firms that make political contributions to the governor or to cabinet members. Florida State Board of Administration, Rule 19A-6.004. Florida also prohibits investment and law firms and their officers, directors, and employees that make contributions or engage in fundraising for state-level candidates from competing for business from the Florida Housing Finance Agency. Rules of the Florida Housing Finance Authority (1991). Several states prohibit contributions from corporations and regulated industries in state elections including Arizona, Ariz. Rev. Stat. Ann. § 16-919; Connecticut, Conn. Gen. Stat. Ann. § 9-333o(a); North Dakota, N.D. Cent. Code §§ 16.1-08-02(l), 16.1-08-01 (10); Pennsylvania, Penn. Stat. Ann. tit. 25, § 3253; South Dakota, S.D. Codified Laws Ann. § 12-25-2; West Virginia, W. Va. Code § 3-8-8; Wisconsin, Wis. Stat. Ann. § 11.38; and Wyoming, Wyo. Stat. § 22-25-102.

particularly appropriate in cases of government contracting and highly regulated industries. Unlike general campaign financing restrictions, such as certain provisions of the Federal Election Campaign Act, which seek to combat unspecified forms of undue influence and political corruption, conflict of interest provisions, such as the MSRB's proposal, are tied to a contributor's business relationship with governmental entities and are intended to prevent fraud and manipulation.[68]

As previously noted, the Commission believes that the MSRB's proposed rule change is closely tailored to accomplish its goal of preventing fraudulent and manipulative acts and practices that stem from quid pro quo arrangements and minimizes any undue burdens on the protected speech

---

[68] Compare 2 U.S.C. §§ 441 (a), (b) (general contribution restrictions in federal campaigns applicable to individuals, corporations and labor unions) with 2 U.SC. §441(c) (prohibition on contributions by federal contractors). Similarly, the prohibitions on solicitation and coordination of campaign contributions are justified by the same overriding purposes which support the business disqualification provisions. The provisions are intended to prevent circumvention of the disqualification provisions in cases where a dealer has or is seeking to establish a business relationship with a municipal issuer. Absent these restrictions, solicitation and coordination of contributions could be used as effectively as political contributions to distort the underwriter selection process. The solicitation and coordination restriction relate only to fundraising activities and would not prevent dealers and municipal finance professionals from expressing support for candidates in other ways.

and associational rights of municipal securities dealers and municipal finance professionals. The proposed rule change is narrowly crafted in terms of the conduct it prohibits, the persons who are subject to the restriction, and the circumstances in which it is triggered.

The proposal is limited to contributions to officials of municipal issuers who can influence the hiring of a dealer in connection with negotiated offerings. The restrictions are triggered only in situations where a business relationship exists or will be established in the near future between the municipal securities dealer and a municipal issuer. Most employees and affiliates of dealers are not covered by the proposal, and the dealer's municipal finance professionals will be able to avail themselves of a personal contribution exception of up to $250, individually, with respect to officials for whom they are eligible to vote. The proposal does not restrict uncoordinated independent expenditures in support of candidates or political views. Moreover, because the contribution limitations take the form of a business disqualification, the proposal does not flatly prohibit individuals from making, or prevent candidates from receiving contributions. In addition, the proposal does not, as some commentators suggest, restrict the ability of municipal securities underwriters and their employees to demonstrate support for state and local officials. Underwriters and their employees may continue to contribute in other ways in political campaigns that do not involve soliciting or coordinating contributions.[69]

---

[69] A number of states separately limit individual contributions in state elections including, for example: Arizona $640 per state wide candidate, $250 per other offices, and a (continued...)

The Commission believes that the proposed rule change is a necessary and appropriate measure to prevent fraudulent and manipulative acts and practices and the appearance of fraud and manipulation in the municipal securities market by eliminating "pay to play" arranged underwritings. The proposal represents a balanced response to allegations of corruption in the municipal securities market; it provides specific prohibitions to help ensure that underwriter selection is based on expertise, not on the amount of money given to a particular candidate for office.

C. Municipal Securities Dealers: Small Firms and Minority and Women Owned Firms

Several commentators believe that the proposal will disadvantage small, regional municipal securities firms and firms owned by minorities or women.[70] Because larger firms

---

[69](...continued)
maximum of $2,000 in total contribution per calendar year, Ariz. Rev. Stat. Ann. § 16-905; Florida, $500 per candidate, Flor. Stat. Ann. 106.08; and Montana, $1,500 collectively to candidates for governor and lieutenant governor, $750 to candidates for state office in a statewide election, $400 to candidates for public service commissioner, district court judge, or state senator, $250 to a candidate for any other public office, Mont. Code Ann. §§ 13-1-101, 13-37-216.

[70] See e.g., letter from Timothy L. Firestine, Director of Finance, Montgomery County Government, to Jonathan Katz, Secretary, Commission (February 24, 1994); letter from Stan W. Helgerson, Finance Director, Village of Carol Stream, Illinois, to Jonathan Katz, Secretary, (continued...)

may have more employees that may be eligible to use the de minimis exemption, these commentators believe that the proposal will provide larger firms an unfair advantage.[71]

---

[70](...continued)

Commission (March 10, 1994); letter from Jeffrey L. Esser, Executive Director, Government Finance Officers Association, to Jonathan Katz, Government Finance Officers Association, to Jonathan Katz, Secretary, Commission (March 10, 1994); letter from Caroline R. Smith, President, Smith Mitchell Investment Group, Inc., to Jonathan Katz, Secretary, Commission (March 9, 1994).

[71] One commentator, for example, states that "larger firms with - multiple departments including those not devoted to public finance will be able to support candidates through contributions made by corporate or other specialists who are not affected by this rule. Minority- and women-owned firms typically are small specialty public finance firms so their employees would be barred from supporting candidates." Letter from Jeffrey L. Esser, Executive Director, Government Finance Officers Association, to Jonathan Katz, Secretary, Commission (March 10, 1994).

Another commentator recommends that the proposal should extend the de minimis exemption to officials for whom the municipal securities finance professionals are not entitled to vote to allow "continuing access to clients and [enable] us to exercise our constitutional and political rights." Letter from Carolie R. Smith, President, Smith Mitchell Investment Group, Inc., to Jonathan Katz, Secretary, Commission (March 9, 1994). Another commentator recommends that the proposal exclude small issues (e.g., $10,000,000 par value or less) to lessen the impact of the rule on small regional, minority-owned, and women-owned

(continued...)

The Commission believes that the proposal will not have a disproportionate effect on minority or women-owned firms or on small and regional firms. The proposal clearly does not prevent local and state officials from selecting minority or women-owned municipal securities dealers for participation in municipal securities issuances.[72] Moreover, the proposal will apply equally to all municipal securities dealers seeking to obtain municipal securities underwriting business. The Commission is not aware of any evidence indicating that the proposed rule change will disproportionately affect minority or women-owned firms, or smaller and regional firms vis-a-vis large dealers. The Commission rejects the notion that campaign contributions are a unique and essential business development mechanism for small, regional, or minority and women-owned firms. As a practical matter, the proposal leaves open all legitimate marketing practices which firms, both large and small, may use to gain underwriting business such as sales presentations, seminars, and marketing documents. Moreover, the Commission believes that the costs of incidental, unintended

---

[71](...continued)

firms. Letter from Raymond J. McClendon, Vice-Chairman and Chief Operating Officer, Pryor, McClendon, Counts & Co., Inc., to Margaret H. McFarland, Deputy Secretary, Commission (March 9, 1994).

[72] The Commission believes that promoting minority and women-owned firms is a valid goal. Other means exist to promote this goal. For example, the Commission understands that some issuers require the underwriting-syndicate to include one or more minority or women-owned firms.

effects, if any, are far outweighed by the benefits of restricting "pay to play" practices.

D. Effect on Women and Minority Candidates

Some commentators suggest that the proposal will adversely affect women and minority candidates for state and local office, or will inhibit the ability of municipal securities professionals to volunteer for public service.[73] The basis for this contention is uncertain, but the proposal is clearly not intended to affect any particular candidate or identifiable group of candidates in an adverse manner. As noted before, the restrictions relate only to those situations where contributions are directed to an official of a municipal issuer with which a dealer might do business. It does not prevent other forms of indirect financial support for a candidate, such as contributions to political action committees that are not controlled by the dealer or its municipal finance professionals, or independent expenditures.[74]

---

[73] "Many such candidates either lack substantial personal resources and/or live in districts with limited resources.It is essential, therefor, that such candidates be able to solicit broad support from outside sources." Letter from Marshall Bennett, President, and Bob Holden, Ethics Task Force, National Association of State Treasurers, to Jonathan Katz, Secretary, Commission (March 11, 1994).

[74] The proposal will not prevent contributions to "special-interest" PACs that are not controlled by the dealer or municipal finance professional unless the special interest PAC solicits contributions for the purpose of supporting an identifiable candidate. Thus, the proposal will have no (continued...)

E. Candidates for Federal Office

Several commentators also suggest that the proposal should apply to contributions made to officials of or candidates for federal office.[75] Several commentators raise

---

[74](...continued)
effect on the ability of market participants to support candidates who represent their ideological, political, or social interests, or on the ability to volunteer for public service, notwithstanding concerns expressed by some commentators to the contrary. Letter from Robin L. Wiessmann, Principal, Artemis Capital Group, Inc., to Arthur Levitt, Chairman, Commission (December 21, 1993).

[75] E.g. letter from Jeffrey L. Esser, Executive Director, Government Finance Officers Association, to Jonathan Katz, Secretary, Commission (March 10, 1994). One commentator objected to the proposal on the grounds that, with respect to municipal officials who are candidates for federal office, the MSRB's authority to adopt rules, subject to Commission approval, regulating campaign contributions of dealers and their employees conflicts with the jurisdiction of the Federal Election Commission ("FEC") under the regulatory scheme established in the Federal Election Campaign Act ("FECA"). Letter from David Norcross, General Counsel, Republican National Committee, to Jonathan Katz, Secretary, Commission (March 11, 1994). Although FECA confers exclusive jurisdiction for enforcing the provisions of FECA, the MSRB rules would not affect; directly or indirectly, the provisions of FECA or their enforcement. Rather, as discussed above, the MSRB's proposal is specifically tailored to eliminate conflicts of interest arising from
(continued...)

concerns that the proposal will restrict contributions to state and local officials running for federal office, without a similar limitation on contributions to the incumbent federal office holder.[76]

---

[75](...continued)

political contributions and similar activities in selecting underwriters in connection with negotiated offerings of municipal securities.

[76] One comment letter, representing state and local officials, states:

> While our organizations recognize the importance of maintaining the integrity of the municipal bond market, we are greatly concerned that the proposed rule is inherently unfair in its limited application to only state and local officials. We fail to understand why this proposed action by the Securities and Exchange Commission is not coupled with a comprehensive limitation on contributions to the federal branch of government, which has perhaps the greatest influence over the strength of the municipal bond market and investor confidence in that market.

Letter from Jerry Abramson, President, The United States Conference of Mayors, Sharpe James, President, The National League of Cities, Barbara Sheen Todd, President, The National Association of Counties, and Bonnie R. Kraft, President-Elect, the Government Finance Officers Association, to Arthur Levitt, Chairman Commission (February 18, 1994).

The Commission believes that it is not necessary to extend the proposal to include contributions to candidates for federal office. The proposal addresses abusive political contributions to officials of issuers who may influence the selection of municipal securities underwriters. Because federal office holders do not influence the underwriter selection process, the Commission believes that it would not be appropriate to include federal candidates under the rule's requirements.

By the same token, the Commission also believes that any resulting hardship to candidates for federal office who are currently local officials is not a reason for eliminating these requirements. The MSRB cannot overlook potential conflicts of interest solely because there are candidates for the same federal office who do not face the same conflicts. In any event, the resulting burden to current local officials does not appear to be significant. Generally, municipal underwriters play a less significant role as contributors in federal elections. Moreover, under federal law there exist general contribution restrictions that limit the amount of contributions that other candidates are able to obtain from municipal securities dealers and municipal finance professionals.[77]

F. Municipal Securities Dealer Affiliates

Several commentators believe that the proposal should apply to contributions from all employees affiliated with the underwriter and from affiliated financial institutions and their

---

[77] See supra note 68.

employees.[78] Several commentators specifically express concern that the proposal excludes contributions by chief executive officers of banks,[79] or by PACs controlled by banks or bank holding companies, which have a municipal securities dealer department or subsidiary.[80] These

---

78 One commentator, for example, believes that the "rule is ineffective because it does not cover all related personnel who can continue to contribute to officials of issuers thereby creating the actual or apparent conflict of interest which the MSRB rule seeks to prevent." Letter from Raymond J. McClendon, Vice-Chairman and Chief Operating Officer, Pryor, McClendon, Counts & Co., Inc., to Margaret H. McFarland, Deputy Secretary, Commission (March 9, 1994).

79 One commentator, for example, states that "[w]e strenuously object to a narrowly-based requirement that diminishes the ability of our Chief Executive and members of our executive committees to participate as community leaders, to engage in political dialogue and to develop our firm's profile in the communities in which we do business to the same extent as local bank chief executives" Letter from William H. Ellis, President and Chief 'Operating Officer, Piper Jaffray Inc., to Jonathan Katz, Secretary, Commission (March 10, 1994).

80 One commentator, for example, states that "[c]ommercial banks would be free to continue making PAC contributions to local and state level political candidates and in the process gain a significant competitive advantage in the selection process for public finance undertakings. Those candidates receiving bank PAC contributions would (continued...)

commentators believe that by exempting affiliated banks and bank holding companies, the proposal provides a "loophole" for continued abuse of political contributions by municipal securities dealers and their affiliates.[81]

---

[80](...continued)

certainly remember such support when bank dealer personnel are introduced or accompanied by commercial bankers in the selection process. It is a typical procedure for the local bank officer to lobby and/or speak in behalf of the hiring of his public finance entity." Letter from Clifford A. Lanier, Jr., The Frazer Lanier Company, to David C. Clapp, Chairman, MSRB (March 1, 1994).

Another commentator states that "[i]t is unreasonable to believe that political candidates, including 'issuer officials,' will be able or need to, discern between contributions from a bank-controlled PAC and a bank's municipal securities 'dealer-controlled' PAC. This appears to us to represent 'business as usual' for bank-controlled municipal dealers while we are both stigmatized and potentially disadvantaged competitively." Letter from William H. Ellis, President and Chief Operating Officer, Piper Jaffray Inc., to Jonathan Katz, Secretary, Commission (March 10, 1994).

[81] "Unfortunately, the proposed rule as written is so severely deficient in ignoring the sophisticated realities of political fundraising undertaken by securities firms, that the loopholes and fine distinctions posed promise to provide a road map for more sinister activities, possibly making the situation worse." Letter from Mark D. Schwartz, to Arthur Levitt, Chairman, Commission (January 31, 1994). Several commentators question the ability of the MSRB or the NASD to enforce Rule G-37. For example, one

(continued...)

The Commission believes that the MSRB's proposed rule change is not deficient merely because it does not include affiliated banks and bank holding companies. Because of the sensitivity to constitutional and other concerns, the Commission believes that the coverage of the proposal is no broader than is necessary to effectuate its purpose and that extending the scope to cover affiliated banks and bank holding companies is not necessary.[82]

G. De Minimis Exemption

Several commentators recommend that the proposal increase the de minimis amount that municipal finance

---

[81](...continued)
commentator believes that "[p]olitical favors will go to those investment banks that flaunt or circumvent the rule while those firms who live by the rules will suffer accordingly." Letter from Carolie R. Smith, President, Smith Mitchell Investment Group, Inc., to Jonathan Katz, Secretary, Commission (March 9, 1994).

[82] The Commission will monitor closely the implementation of the proposal and its effects on the market, and if it determines that abusive practices continue to exist, will encourage the MSRB to expand the scope of the rule. In response to the suggestion that financial advisers be required to register as municipal securities broker-dealers and be subject to the proposal, the Commission notes that such a recommendation is beyond the scope of this proposal. See e.g. letter from Vivian Altman, Altman & Co., to Jonathan Katz, Secretary, Commission (January 31, 1994).

professionals may contribute.[83] Several commentators recommend that the rule should provide a "good faith" exemption for inadvertent violations.[84] One commentator

---

[83] These commentators express concern that inadvertent violations by municipal securities dealers or associated persons covered by the rule may prevent dealers from participating in an underwriting, and, thus, raise the cost of a municipal securities issuance. For example, one commentator states that "we are concerned that your rule could deprive a state or local government of the opportunity to work with a company which may be offering the most desirable rates simply due to a technical infraction." Letter from Jerry Abramson, President, The United States Conference of Mayors, Sharpe James, President, The National League of Cities, Barbara Sheen Todd, President, The National Association of Counties, and Bonnie R. Kraft, President-Elect, the Government Finance Officers Association, to Arthur Levitt, Chairman, Commission (February 18, 1994).

[84] For example, one commentator states that "[c]learly, the tradition of broker-dealer regulation in the U.S. is based upon the requirement that securities firms have adequate policies and procedures in place to assure compliance with laws and regulations not that each broker-dealer be a guarantor of perfect compliance." Letter from William H. Ellis, President and Chief Operating Officer, Piper Jaffray Inc., to Jonathan Katz, Secretary, Commission (March 10, 1994). Another commentator believes that the proposal, "consistent with many other rules and regulations applicable to the securities industry, may achieve its purposes but temper its remedy for firms with adequate compliance procedures and supervision." Letter from D. Kelly, A.G. Edwards & Sons, Inc., to Jonathan Katz, (continued...)

recommends that the rule provide a "safe harbor" provision for certain contributions.[85] Another commentator believes that the proposal should exempt contributions made for legitimate purposes.[86]

Several commentators believe that the de minimis exemption should be expanded to include contributions to officials for whom the municipal finance professionals are not

---

[84](...continued)

Secretary, Commission (March 10, 1994). See also letter from Raymond J. McClendon, Vice-Chairman and Chief Operating Officers, Pryor, McClendon, Counts & Co., Inc., to Margaret H. McFarland, Deputy Secretary, Commission (March 9, 1994); letter from George B. Pugh, Jr., Chairman, Municipal Securities Division, Public Securities Association, to Jonathan Katz, Secretary, Commission (March 11, 1994).

[85] For example charitable contributions, contributions to non-partisan associations in which elected officials may be members or participants, support of ballot propositions, certain services in the normal course of business, contributions by spouses or household members, contributions to national political parties, contributions to state and local political parties and certain contributions to political action committees. Letter from D. Kelly, A.G. Edwards & Cons, Inc., to Jonathan Katz, Secretary Commission (March 10, 1994).

[86] Letter from Raymond J. McClendon, Vice-Chairman and Chief Operating Officer, Pryor, McClendon, Counts & Co., Inc., to Margaret H. McFarland; Deputy Secretary, Commission (March 9, 1994).

entitled to vote.[87] These commentators believe that the proposal prevents municipal securities dealers from establishing business relationships with issuers,[88] and from supporting candidates with similar views important to the municipal finance professional or to the municipal securities broker-dealer firm.[89] One commentator recommends that the

---

[87] For example, one commentator believes that " [d]ealers should not be prohibited from making contributions to persons for whom they are unable to vote. They should have a right to support the candidates of their choice." Letter from Jeffrey L. Esser, Executive Director, Government Finance Officers Association, to Jonathan Katz, Secretary Commission (March 10, 1994).

[88] Letter from Carolie R. Smith, President, Smith Mitchell Investment Group, Inc., to Jonathan Katz, Secretary Commission (March 9, 1994).

[89] For example, one commentator believes that "[t]he provision limiting contributions to one's voting jurisdiction denies municipal securities professionals access to politicians who influence their corporate and individual political interests. Specifically, municipal securities professionals will be denied the ability to support politicians who champion their personal beliefs or corporate concerns. For example, a firm headquartered in New York City whose president and employees •live on Long Island would be unable to send a representative to a dinner for the mayor of New York City or for the mayor's political opponent. Yet the mayor's decisions on issues such as zoning, corporate taxes, and transportation policy significantly impact the company's viability." Letter from Carolie R. Smith, President, Smith Mitchell Investment Group, Inc., to Jonathan Katz, Secretary, Commission (March 9, 1994).

proposal allow contributions to candidates that represent the area in which the professionals' principal office is located.[90]

The Commission believes that the MSRB's determinations as to the amount of the de minimis exemption and limiting its application to contributions to officials for whom the municipal finance professional is entitled to vote are appropriate and reasonable. As discussed, the proposal provides specific guidelines to prevent "pay to play" contributions. The proposal provides an appropriate balance between limiting "pay to play" practices and the ability of dealers and their employees to demonstrate support for state and local candidates. The proposal recognizes that certain contributions made for legitimate political purposes present less risk of a conflict of interest or the appearance of a conflict of interest. Although an individual may have a legitimate interest in making contributions to candidates for whom she is ineligible to vote, there is a greater risk in such circumstances that the contribution is motivated by an improper attempt to influence municipal officials. Thus, the proposal enables municipal finance professionals to contribute $250 per election to candidates for whom they are entitled to vote without triggering the proposal's business limitation. As discussed, the proposal does not prevent dealers or their employees from demonstrating support for local and state officials in other ways including volunteer political campaign activity.

---

[90] Letter from Gerald E. Pelzer, President, Clayton Brown & Associates, Inc., to Jonathan Katz, Secretary, Commission (March 10, 1994).

H. General Provisions

Several commentators believe that the proposal is operationally too burdensome to implement. These commentators believe that because of the number and types of persons subject to the rule's prohibitions, it will be difficult for municipal securities dealers to implement and enforce compliance procedures.[91] Some commentators

---

91 For example, Piper Jaffray Inc. expresses concern regarding the ability of broker-dealer firms to screen newly hired employees or current employees seeking employment with the firm's municipal securities departments, and the ability to hire civil servants. Piper Jaffray Inc. believes that "[t]his would require firms to screen all applicants for these jobs by requiring them to declare to whom they made political contributions and make judgmental evaluations as to whether their earlier campaign activities would be potentially violative of the rule and not offer a job to any offending contributor." Piper Jaffray Inc. believes that this will almost certainly expose broker-dealer firms to the risk of civil litigation. Letter from William H. Ellis, President and Chief Operating Officer, Piper Jaffray Inc., to Jonathan Katz, Secretary, Commission (March 10, 1994).

Another commentator states that "a person who has made a contribution within the past two years apparently taints a firm which hires the individual even if the individual was not involved in the municipal securities business at the time of the contribution. Two serious problems exist. The first is that even a firm with strict reviews for hiring may find itself barred.... The second is that many active citizens will find themselves de facto barred from entering the public finance, banking and brokerage businesses." Letter from D.

(continued...)

believe that the proposal's disclosure and recordkeeping requirements are overly burdensome.[92] Several commentators also believe that the scope of the proposal is uncertain and recommend that it provide more complete standards regarding

---

[91](...continued)
Kelly, A.G. Edwards & Sons, Inc., to Jonathan Katz, Secretary, Commission (March 10, 1994).

[92] E.g., letter from A.B. Krongard, Chief Executive Officer, Alex, Brown & Sons, to Jonathan Katz, Secretary, Commission (March 15, 1994); letter from Robert F. Price, Chairman, Federal Regulation Committee, Securities Industry Association, to Jonathan Katz, Secretary, Commission (March 17, 1994). The Securities Industry Association believes that the proposal's reporting provisions should be amended to: (1) require quarterly submissions for only those quarters in which the dealer has any contributions to report; (2) delete the requirement to report lists of issuers with which the dealer conducts municipal securities business; and (3) delete the requirement to disclose the name, company, role, and compensation arrangement of any person employed by the dealer to obtain municipal securities business.

employee contributions,[93] the use of consultants and law firms,[94] bonds issued by corporations with

---

93 For example, A.G. Edwards & Sons, Inc. believes that the "provision is ambiguous. Read most broadly the definition of municipal finance professional in proposed Rule G-37 could be construed to include any retail broker who sells. municipal securities.... As a result of the possible ambiguity and the changing application, firms employing retail brokers likely will interpret the provision broadly to avoid being barred from the municipal finance business. The result will be that numerous brokers who have no participation in securing municipal securities business will be barred from political activities." Letter from D. Kelly, A.G. Edwards & Sons, Inc., to Jonathan Katz, Secretary, Commission (March 10, 1994).

94 E.g., Letter from William H. Ellis, President and Chief Operating Officer, Piper Jaffray Inc., to Jonathan Katz, Secretary, Commission (March 10, 1994). One commentator recommends the proposal clarify that the definition of municipal finance professional excludes independent law firms or persons retained by a dealer for purposes other than the solicitation of municipal securities business. Letter from Richard H. Martin, Attorney, Leonard, Street and Deinard, to Jonathan Katz, Secretary, Commission (March 8, 1994).

One commentator recommends that the proposal should be clarified to exclude from the definition of municipal finance professional any independent firms or persons retained by a broker-dealer for purposes other than the solicitation of municipal securities business. Letter from Richard H. Martin, Attorney, Leonard, Street and Deinard, to Jonathan Katz, Secretary, Commission (March 8, 1994).

assistance of local governments,[95] the definition of "election,"[96] and the definition of "official of such issuer."[97] One commentator requests that the proposal contain a "sunset" provision to require the MSRB to review rule G-37 after a fixed number of years.[98]

The Commission believes that the proposal's provisions are sufficiently specific to permit compliance with its terms. The Commission also understands that industry efforts are currently underway to draft proposed guidelines to assist dealer compliance with the proposal. In addition, the MSRB will provide continued interpretive guidance to assist

---

95 Id.

96 One commentator, for example, states that "[a]n election should be defined and it should be made clear that if a contributor gives for a specified election, the amount shall only be considered as a contribution for the election for which the amount was given even if the candidate has the legal right to carry over amounts to other elections." Letter from D. Kelly, A.G. Edwards & Sons, Inc, to Jonathan Katz, Secretary, Commission (March 10, 1994).

97 "An influence standard leaves the industry uncertain as to whom contributions may be made and, judged retrospectively, may cause inadvertent violations." Id.

98 This "would allow all parties to regularly review G-37 to determine whether G-37 is effective and meeting the goals it was created to achieve and to accommodate any other relevant developments such as campaign finance reform." Letter from Carolie R. Smith, President, Smith Mitchell Investment Group, Inc., to Jonathan Katz, Secretary, Commission (March 9, 1994).

dealer compliance with the proposal. The Commission, in accordance with its statutory mandate, will continue to monitor the implementation of the proposal and the effects the proposal may have on the market.

I. Amendment No. 1

The Commission finds good cause for approving the MSRB's Amendment No. 1, pursuant to Section 19(b) (2) of the Act, prior to the thirtieth day after the date of publication of notice of the amendment. As originally submitted, the proposal's prohibitions on municipal securities business would arise from contributions made on or after April 1, 1994. The MSRB filed the amendment to change the April 1, 1994 date to a date 10 days after publication in the Federal Register of the order approving the proposal. The MSRB also amended the proposal to change the effective date of the proposal's disclosure and recordkeeping requirements to a date 10 days after publication of. the approval order in the Federal Register. Thus the proposal's prohibitions will arise from contributions made on or after [insert date 10 days after publication in the Federal Register]. The proposal's disclosure and recordkeeping requirements also will not be effective until [insert date ten days after publication in the Federal Register]. The Commission believes that the amendments will facilitate compliance by municipal securities dealers. The amendments, in conjunction with the proposal's notice and comment period, will provide municipal securities dealers sufficient time to adopt and implement procedures to comply with the proposal.

VI. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the MSRB's Amendment No. 1. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of the submission, all subsequent amendments, all written statements with respect to the amendment that are filed with the Commission, and all written communications relating to the amendment between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. § 552, will be available for inspection and copying in the Commission's Public Reference Section. Copies of the amendment also will be available for inspection and copying at the principal off ice of the MSRB. All submissions should refer to the file number in the caption above and should be submitted by [insert date 21 days from date of Publication].

VII. Conclusion

For the foregoing reasons, the Commission finds that the proposed rule change is consistent with the Act and the rules and regulations thereunder applicable to the MSRB and, in particular, Section 15B(b)(2)(C).

IT IS THEREFORE ORDERED, pursuant to Section 19(b) (2) of the Act, that the proposed rule change and Amendment No. 1 described above be, and hereby are,

approved and shall be effective [insert date ten days after publication in the Federal Register][99]

By the Commission.

Jonathan G. Katz
Secretary

/s/ Margaret H. McFarland
By: Margaret H. McFarland
Deputy Secretary

---

[99] The Commission simultaneously issued an order relating to this matter, "Order Preliminarily Declining to Issue Stay Sua Sponte and Establishing Guidelines for Consideration of Stay Applications." Securities Exchange Act Release No. 33870 (April 7, 1994).

APPENDIX C

SECURITIES AND EXCHANGE COMMISSION

Securities Exchange Act of 1934
Release No. 33870; File No. SR-MSRB-94-2

April 7, 1994

ORDER PRELIMINARILY CONSIDERING WHETHER TO ISSUE STAY SUA SPONTE AND ESTABLISHING GUIDELINES FOR SEEKING STAY APPLICATIONS

The Securities and Exchange Commission (the "Commission") is simultaneously herewith issuing an order approving a rule change proposed by the Municipal Rulemaking Board (the "MSRB").[1] The rule change implements Rule G-37 governing political contributions by municipal securities dealers and certain of their employees and amends Rules G-8 and G-9.[2]

The Commission understands that judicial review of this approval order will likely be sought. Indeed, on March 21, 1994 a complaint was filed in the United States District court for Middle District of Alabama, challenging the constitutionally of the MSRB proposal apparently under the mistaken assumption that the Commission already had approved the rule.[3] Although the Commission has moved to

---

1 Securities Exchange Act Release No 33838 (April 7, 1994) (the "Approval Order").

2 The Approval Order describes in detail the various provisions of the MSRB rule change.

3 Blount, Parrish & Roton, Inc., et al. v. SEC, iv. Act. No. 94-A-345-N (M.D. Ala.).

dismiss this district court action as improperly filed,[4] it notes that the preliminary injunctive relief sought by plaintiffs is essentially the same as a stay of the rule's effectiveness.

The Commission has authority to grant stays in connection with petitions seeking review of a Commission order, and courts unless an application for a stay has first been made to the Commission. In connection with the Approval Order, the Commission preliminarily has considered sua sponte whether a stay of the effectiveness of some of all of the proposed rule change's provisions is appropriate in light of the constitutional concerns which have been raised by commentators, but has concluded for reasons discussed below that such relief is not warranted at this time. Nevertheless, this determination does not obviate the need for petitioners seeking a stay to mae an application to the Commission before seeking such relief n a court of appeals. In the event that applications are filed with the Commission, it will consider de novo such applications and, in the discussion below, ha identified certain considerations which should be addressed by review of such applications.

When evaluating the appropriateness of a stay under Section 25(c) of the Act, the Commission generally considers four factors: (1) whether there is a strong likelihood that a party will succeed on the merits in a proceeding challenging the particular Commission action (or, if the other factors strongly favor a stay, that there is a substantial case on the merits); (2) whether, without a stay, a party will suffer

---

[4] Jurisdiction to review a Commission order approving an SRO rulemaking is vested, pursuant to Section 25(a) of the Act, exclusively in the United States courts of appeals.

irreparable injury; (3) whether there will be substantial harm to any person if the tay were granted and (4) whether the issuance of a stay would likely serve the public interest.[5] The evaluation of theses factors will vary with the equities and circumstances of each case.[6] However, when considering whether a stay should be granted sua sponte, the Commission's consideration of thee factors is necessarily truncated by the absence of particularized showing of harm by an applicant or an enumeration of specific deficiencies in the Approval Order. In understanding its analysis sua sponte, the Commission focuses only on the constitutional concerns that have been raised in connection with the rule change, because of the special nature of those concerns.

The MSRB rule change contains three functionally distinct provisions: a business disqualification provision, a solicitation and coordination provision, and disclosure and recordkeeping provisions. While the rule change;s provisions function as an integrated measure, the three types of provisions separately advance the rule change's prophylactic purpose of preventing improper and fraudulent activities by municipal securities dealers and certain of their employees. In approving the rule change, the Commission has treated the three types of provisions, and indeed is of the view that the MSRB intended that they be treated, as severable for purposes

---

5 See e.g., Order Denying stay of Commission Order Approving Proposed Rule Change by the NASD, Exchange Act Release No. 33424, (January 5, 1994); see also Washington Metropolitan Area Transit Comm. v. Holiday Tours, Inc., 559 F.2d 841, 843 (D.C. Cir. 1977); Virginia Petroleum Jobbers v. FPC, 259 F.2d 921 (D.C. Cir. 1958).

6 Virginia Petroleum Jobbers, 259 F.2d at 925.

of review. Accordingly, in determining whether a stay is warranted, it is necessary to consider the four factors for each of the severable parts of the rule change.

1. The disclosure and recordkeeping provisions.

The commentators to the MSRB proposal did not identify any specific constitutional objections to the disclosure and recordkeeping provisions of the MSRB rule change—Rule G-37 sections (e)-(h) and the amendments to Rules G-8 and G-9. As a threshold matter, therefore, stay applicants would have to offer reasonable grounds for the failure to urge such objection before the Commission prior to its approval of the rule See Section 25(c)(1) of the Act. Even putting that matter aside, the Commission preliminarily is of the view that no substantial constitutional basis exists for challenging the disclosure and recordkeeping provisions. The disclosure and recordkeeping provisions represent at most marginal effects on associational rights under the First Amendment and certainly do not infringe on contributors' free communications. As the Supreme Court recognized in Buckley v. Valeo, 424 U.S. 1, 68 (1976),"disclosure requirements—certainly in most applications—appear to be the least restrictive means" of curbing illicit quid pro quo arrangements in connection with political contributions.

Moreover, the disclosure and recordkeeping requirements will not result in foreseeable irreparable harm to dealers or their associated MFPs (or, indeed, significant costs of any sort). Although the recordkeeping and disclosure provisions may result in some burden for dealers, such dealers are by virtue of existing Commission and MSRB regulations already subject in the ordinary course of business to significant recordkeeping and disclosure requirements and are

well-equipped to prepare and maintain records in compliance with the rule change. The Commission believes that a stay of the disclosure and recordkeeping requirements would harm the public, because the provisions permit monitoring of political contributions and advance important regulatory objectives, including the prevention of fraud, the promotion of just and equitable principals of trade and the protection of investors and the public interest.

Accordingly, it would appear as a preliminary matter that a sua sponte stay of the disclosure and recordkeeping provisions is warranted at this time.

2. The business disqualification provision.

As discussed in the Approval Order, the Commission believe that the business disqualification provision is supported by a compelling interest. In order to mount a successful First Amendment challenge to the provision, a petitioner must show that no compelling interest has bee adduced in support of the provision or that the provision is not sufficiently closely drawn to avoid unnecessary abridgments of speech and associational rights.

As previously notes, the Commission believes the provision serves a compelling interest. As to whether the provision is sufficiently closely drawn, the Commission considered and rejected in the Approval Order the objections raised by the commentators; the Commission does not believe the assertions that the rule change is not sufficiently narrow merit further analysis at this time.

Applicants arguably will be able to present a more cognizable claim of irreparable injury with respect to the

business disqualification provision as compared to the disclosure and recordkeeping provisions, if only in the sense that a colorable claim of a significant infringement of First amendment rights might give rise to irreparable injury.[7] The Commission notes, however that such a view if probably less appropriate here than in other circumstances. The alleged injury caused by the disqualification provision is not particularly severe, because other avenues of participation in municipal elections are not foreclosed. See Buckley, 424 U.S. at 21 (contributions limitations are at most "marginal restrictions" since they do not "in any way infringe on the contributor's freedom to discuss candidates and issues.").

Irreparable injury, moreover, is not sufficient by itself to warrant a stay, but typically must be accompanied by a strong showing with respect to the other factors.[8] In this regard, the Commission believes that there could be

---

[7] Cf. Elrod v. Burns 427 U.S. 347, 373-74 (1976) (finding irreparable injury where employees not affiliated with political party were threatened with immediate loss of jobs because of non-affiliation; see also National Treasury Employees Union v. United States, 927 F.2d 1253 (D.C. Cir. 1991) (denying preliminary injunction with respect to constitutional challenge to honoraria ban in absence of showing that First Amendment interests are being impaired).

[8] See generally Washington Metropolitan Area Transit Com. v. Holiday Tours, Inc. 559 F.2d at 843; Cuomo v. NRC, 772 F.2d 972, 974 (D.C. Cir. 1985). Nor are municipal officials and candidates irreparably harmed by these provisions. The conduct of such officials is not regulated by Rule G-37 and, of course, they generally remain free to solicit and accept campaign contributions.

substantial harm to municipal securities market participants if a stay were granted. As discussed in the Approval Order, the Commission determined that Rule G-37 will serve important public interest concerns by contributing to the elimination of improper an fraudulent practices in the municipal securities market. Elimination of abuses will serve to promote market integrity and investor confidence. Moreover, permitting these practices to continue will adversely affect competing underwriters. Because application of the rule will avoid hardships to third parties and is in furtherance of the public interest, the balance of hardships does not appear to favor issuance of a sua sponte stay.

3. Solicitation and Coordination Provisions.

Many of the same considerations that apply in evaluating the propriety of a sua sponte stay with respect to the business disqualification provisions apply with equal force to the solicitation and coordination provisions. Although the solicitation and coordination provisions present somewhat different First Amendment issues, they are supported by a compelling governmental interest and apply only in those circumstances where a business relationship with a municipal issuer exists or is being sought. Moreover, in approving the rule change, the Commission construes the ban on solicitation narrowly as applying to explicit solicitations of contributions, and not to generalized solicitations of support for a candidate or his views. the Commission believes this construction is consistent with the MSRB's intent.

Challenges to the solicitation and coordination provisions conceivable could involve substantial First Amendment claims. Because the solicitation provision will be narrowly construed to apply only to the relatively specific

solicitation of contributions, however, the Commission is of the view that any irreparable injury would likely be slight in that the limitations would not affect the ability of dealers or their associated MFP's to engage in a free exchange of political views. Moreover, the Commission believes that the harm to third parties and the public interest from a stay are likely to be significant for the same reasons discussed in connection with the business disqualification provision. Accordingly, a stay as to the solicitation and coordination provisions does not appear to be warranted.

4. Applications Seeking a Stay of the Commission's Order

Although the commission believes it useful and expeditious to set forth its general view of issues related to a stay, the commission is aware that there may be relevant factors or considerations relating to a stay not raised in any of the comment letters. To facilitate the Commission's review of any application for a stay that may be made notwithstanding the foregoing discussion, the Commission believes that it is important that applications provide adequate explanations from which the Commission meaningfully can evaluate the asserted bases for the stay application. In particular, the Commission believes that as to legal claims raised by an applicant not previously raised before the Commission by either the applicant or other commentators, the applicant should provide an explanation for the failure to do so in the stay application. Applicants should identify the provisions of the rule change for which the stay is sought and the reasons in each case therefor. To the extent that the stay application rests on asserted deficiencies in the Commission's analysis, either with respect to the Commission's determination to approve the rule change or to refrain from

granting a stay sua sponte, such deficiencies should be identified with particularity. Further, all applicants also should describe with specificity the nature of any alleged harm or injury if the challenged portion of the MSRB rule change becomes effective.

The Commission also wishes to alert potential applicants and petitioners to certain procedural and timing requirements for determining which court of appeals will have jurisdiction in the event that review of the Approval Order is sought. If within ten days after issuance of this order the Commission receives, as specified in the Commission's Rules of Practice, 15 C.F.R. 201.23, court-stamped copies of petitions for review filed in more than one court of appeals, the Judicial Panel on Multidistrict Litigation will randomly select one of those courts to have jurisdiction over all cases challenging the order. See 28 U.S.C. 2112(a). If, within that a ten-day period, the Commission receives one or more petitions filed in only one circuit, that court of appeals will have jurisdiction over all cases challenging the rule. id. If no petition for review is received within the ten-day period, the court of appeals in which a petition for review if first filed will have jurisdiction. id. The ten-day window contemplated by Section 2112(a) commences upon entry of the Commission's order approving the rule change, rather than upon effectiveness of the rule. Persons who contemplate seeking review of the Commission's order should carefully review these provisions and the filing deadlines therein to preserve the possibility of jurisdiction in the court of appeals in which the petition is field.

Conclusion

The Commission has preliminarily determined that a sua sponte stay is not warranted with respect to any of the provisions of Rule G-37 and the amendments to Rule G-8 and G-9. In the event that an application to stay effectiveness of certain provisions of Rule G-37 and the amendments to Rules G-8 and G-9 is filed with the Commission, the Commission will consider the application de novo.

By the Commission.

Jonathan G. Katz
Secretary

/s/ Margaret H. McFarland
By: Margaret H. McFarland
Deputy Secretary

APPENDIX D

SECURITIES AND EXCHANGE COMMISSION

Securities Exchange Act of 1934
Release No. 34008; File No. SR-MSRB-94-2

May 4, 1994

ORDER DENYING APPLICATION OF WILLIAM B. BLOUNT FOR A STAY

On April 7, 1994, the Commission issued an order approving a rule change proposed by the Municipal Securities Rulemaking Board (the "MSRB").[1] The rule change implements Rule G-37 governing political contributions by municipal securities dealers and certain of their employees and amends Rule G-8 and G-9.[2] At the same time, the Commission issued an Order Preliminarily Considering Whether to Issue Stay Sua Sponte and Establishing Guidelines for Seeking Stay Applications (the "Preliminary stay Order").[3] In that order the Commission set forth the standards governing applications for a stay pending judicial review and set forth its preliminary analysis of whether a stay of the Approval Order should be granted. The Commission concluded "that such relief is not warranted at this time." The Commission noted, however, that "this determination does not obviate the need for petitioners seeking a stay to make an application to the Commission before seeking such

---

1 Securities Exchange Act Release No. 33868 (April 7, 1994) (the "Approval order").

2 The Approval Order described in detail the various provisions of the MSRB rule change.

3 Securities Exchange Act release No. 33870 (April 7, 1994).

relief in a court of appeals. In the event that applications are filed with the Commission, it will consider do novo such applications."

Pursuant to the terms of the Approval Order the MSRB rules took effect on April 25, 1994. On that day William B. Blount applied to the commission for a stay of sections (b), (c) and (d) of rule G-37. These sections relate to two of the provisions in the rule, the business disqualification provision and the contribution solicitation and coordination provision.[4] Blount does not seek a stay of the this provision effected by the rule change, the disclosure and recordkeeping provisions contained in paragraph (e) of rule G-37 and in the changes to rules G-8 and G-9.

As the Commission noted in its Preliminary Stay Order, the three provisions are "severable for purpose of review."[5]

---

[4] Section (b) contains the business disqualification provision. Section (c) contains the solicitation and coordination provision. Section (d) prohibits persons covered by the rule from "directly or indirectly, through or by any other person or means, do[ing] any act which would result in a violation of sections (b) or (c)."

[5] The Commission stated:

> While the rule change's provisions function as an integrated measure, the three types of provisions separately advance the rule change's prophylactic purpose of preventing improper and fraudulent activities by municipal securities

(continued...)

Accordingly, we will consider separately whether to stay each of the two challenged provisions, Sections (b) and (c).[6] We conclude for the reasons discussed in detail below that a stay is not warranted as to either provision.

We note at the outset that applicant's situation presents a particularly striking illustration of the need for the Rule. Applicant is a member of a firm which, he states, does substantial municipal securities business (as defined in the rule) for the state of Alabama and its political subdivision. He is also Chairman of the Alabama State Democratic Party. As such, he apparently engages in precisely the conduct that created the need for the rule—large-scale fundraising for state and local officials accompanied or followed by seeking business for his firm from those same officials. This is a

---

[5](...continued)

dealers and certain of their employees. In approving the rule change, the Commission has treated the three types of provisions, and indeed is of the view that the MSRB intended that they be treated, as severable for purposes of review. Accordingly, in determining whether a stay os warranted, it is necessary to consider the four factors (governing whether to grant a stay) for each of the severable parts of the rule change.

[6] There is no need to deal separately with whether a stay of section (d) is warranted, since a stay of one or both of the other sections would effectively operate as a stay of section (d) as it applies to that section or sections. Applicant does not contend that if the Commission does not stay sections (b) or (c), it should nonetheless stay section (d).

situation that presents at the very least the appearance of inappropriate influence being brought to bear on who gets municipal securities business in the state.

Applicant contends that because he engages in a substantial amount of fund-raising and, at the same time, does a substantial amount of business with those for whom he raises funds, the MSRB rule will greatly burden him by forcing him to give up one or the other. While we do not believe that all of the applicant's concerns are well founded, he likely will be burdened by the rule in that he will no longer be able to engage simultaneously in incompatible fund-raising and municipal securities activities. If that burden proves to be a significant one, however, it is because applicant has an unusually pronounced conflict of interest.

As significant as the burden could be on this individual, we believe that a stay would adversely affect investors and other third party participants in the municipal securities markets, who rely upon the issuer to select the most qualified underwriter to conduct the due diligence necessary for their protection, and also would harm the public interest. We also do not believe that applicant has made out a case that he is likely to prevail on review of the Approval Order. Accordingly, we do not believe a stay is warranted.

5. Alleged Irreparable Harm and Likelihood of Success on the Merits as to Section (b) of the Rule, the Business Disqualification Provision

A. Irreparable Harm

Applicant offers no persuasive reason why the business disqualification provision contained in Section (b) should be stayed. He asserts that he is a municipal securities professional, such that contributions he makes to officials would preclude him and his firm for two years thereafter from obtaining municipal securities business over which those officials have influence. He further asserts that "[b]ecause virtually every Alabama constitutional officer is an 'official of an issuer,' Blount must abandon his First Amendment right to make contributions if he seeks to continue his profession as a dealer in municipal securities."

Applicant suffers no harm at all to his expressive rights as to contributions to candidates that are running for state-wide constitutional office, since he presumably is entitled to vote for them and thus may contribute up to $250 to each such official. This limit would not impede applicant's ability to express support for these candidates. The giving of money is a symbolic expressive act, but the quantity of communication from the act "does not increase perceptibly with the size of his contribution." Buckley v. Valeo, 424 U.S. 1, 21 (1976). We do not believe that applicant has shown he would suffer any perceptible irreparable injury to his First Amendment rights from this restriction as it might effect his contributions to these officials.

He also cannot show substantial harm as to contributions to candidates for whom he would not be entitled

to vote, even though a contribution of any amount to such a candidate could trigger the business disqualification provision. While this may impose a somewhat greater burden on applicant's ability to engage in the symbolic act of contributing, it does not significantly infringe on his right to express support for these candidates. The Supreme Court has recognized that giving a candidate money is not the same as discussing issues or debating qualifications which are entitled to greater protections: "[a] contribution serves as a general expression of support for the candidate and his views, but does not communicate the underlying basis for the support." Buckley, 424 U.S. at 20. To the extent this restriction might be viewed as causing applicant irreparable injury, that injury is marginal.[7] At any rate, even a significant interference with rights protected by the First Amendment may be justified by a sufficiently compelling governmental interest so long as the interference is closely drawn to avoid unnecessary abridgment of those protected rights. Buckley, 424 U.S. at 25.

Applicant's central claim as to irreparable harm is that he could also be precluded from directing which officials get contributions from the Democratic Party. He asserts that after raising money for the Democratic Party in Alabama, "[t]he money raised is contributed at my discretion, as Chairman of the Alabama Democratic Party, to candidates who need it . . .."

---

[7] The applicant also claims that his family will be unable to contribute to candidates. But that will only be so if he is directing their contributions, thus seeking to evade the rule's provisions.

Should applicant be compelled to cede those duties to another party official, however, it would not constitute a serious infringement on his First Amendment rights. His activities are, from his standpoint, no different than if he wished to give large donations personally. The fact that he might be precluded from doing so as party chairman constitutes no greater infringement of his rights of expression than does a restriction on his personal contributions.[8]

A. Likelihood of Success on the Merits

In light of the marginal restriction this provision would impose on applicant's rights to expression, we think he must make a strong showing of a likelihood of success on appeal. We do not believe he has shown that. As we explained in our Approval Order, the business disqualification provision operates to ensure that negotiated underwriting and other non-competitive municipal securities business is freed from the taint and the appearance of taint that follows when municipal securities dealers and municipal finance professionals give political contributions to those with influence over whether they are awarded business. The concern that political contributions can distort the award of public contracts is a common one. The business

---

[8] Although applicant claims that as a result of these provisions he could be forced to give up his job as state party chairman, we are unaware of any constitutional right he has to serve on that particular job. Applicant does not claim that the rule would in any respect preclude the party from making contributions. He does claim that he has not trained anyone else to do these tasks, but he has been on notice since at least January that this rule might be imposed.

disqualification provision, far from being a novel species of restriction, is akin to similar prohibitions on political contributions by government contractors under both federal and state law. See approval Order at 34-35 & nn. 67 & 68.

Applicant suggests, however, that the public interest is not compelling here because the Commission's concern is with the integrity of the municipal finance markets, rather than with the integrity of the political process. The municipal securities markets, and those who deal in those markets, are highly regulated precisely because there is a strong public interest in the fair, honest, and efficient operation of the markets. The fact that the commission does not regulate state elections does not mean that there is no compelling interest on the part of the Commission or MSRB in regulating contributions made by dealers and municipal securities professionals to officials who are in a position to influence the award o municipal securities business.[9] Because the preservation of the integrity of those markets is of compelling public importance, the influence of contributions in state and local elections on the award of municipal securities business is a matter of high public concern within the Commission's jurisdiction.

While applicant challenges whether there actually is a problem from these "pay-to-play" practices, there is a more than adequate factual basis for concluding that it is a serious problem. The Supreme Court has acknowledged that "the

---

[9] Cf. 15 U.S.C. 791(h) (prohibiting contributions by public utility holding companies and their subsidiaries to candidates for state office); 2 U.S.C. 441b(c) (prohibiting national banks from making contributions to state elections).

scope of such pernicious practices" as quid pro quo exchanges of contributions for factors "can never be reliable ascertained.: and has not required a definitive factual showing a precondition to contribution limitations. Buckle v. Valeo, 424 U.S. 1, 27 (1976).

In approving the rule, we cited abundant evidence that pay-to-play in many instances is and has come to be considered an ordinary cost associated with obtaining municipal underwriting business. See Approval Order at 8-15. The MSRB, which is composed of embers of the municipal securities industry and others, ha been concerned with the problem for several years. See Approval Order at 12-13.[10] Over 50 municipal securities dealers have agreed to adhere to a voluntary Statement of Initiative providing that political contributions made, in any manner, for the purpose of influencing the awarding of municipal finance business should be prohibited. Approval Order at 14. In response, notably, some government officials have urged that firms that comply with those guidelines be boycotted. See id. at 14 n.40.[11] The numerous comments received by both the

---

[10] The Commission's Decision of Market Regulation has described the seriousness of the problem and has recommended regulation. United States Securities and Exchange Commission, Division of Market Regulation, Staff Report on the Municipal Securities Market, 9-11, 32-34 (1993).

[11] Applicant's statement that the implementation of the disqualification "will dramatically affect" the "dynamics of state and local elections," Stay Memorandum at 25, appears to be a concession that underwriter funds are an important

(continued...)

MSRB and the commission from participants in all phases of the municipal securities market were in near unanimous agreement that pay-to-play, and the public perception of pay-to-play, are significant problems.[12]

Finally, applicant argues that even if there is a problem, narrower solutions, such as only restricting contributions given for the purpose of influencing the awarding of contracts, or relying on disclosure alone, would be sufficient. As the Supreme Court explained in rejecting similar arguments in Buckley, 424 U.S. at 27-28, bribery laws deal "only with the most blatant and specific attempts of those with money to influence government action," and, while disclosure serves salutary purposes, it is reasonable to conclude that "disclosure was only a partial measure" and that contribution limitations are necessary to deal with "the reality

---

[11](...continued)

factor in many such elections. But it is hard to argue that a restriction on contributions will "dramatically affect" elections while at the same time asserting that there is no basis for public suspicion that the award of municipal securities business is often influenced by those contributions.

[12] There were criticisms of the rule, but very little disagreement that there is a problem. The only commentator applicant cites to raise a doubt that the problem is significant is the representative of the state officials who receive the contributions, and even he said only that "there have been relatively few reported instances of improper behavior in the market." Stay Memorandum at 14 n.7 (emphasis added).

or appearance of corruption inherent" even when disclosure is required.[13]

---

[13] Applicant also suggests that the rule violates the equal protection component of the due process clause of the Fifth Amendment. Stay Memorandum at 22 n.9. It is certainly rational to conclude that the central role municipal securities dealers play in the municipal securities market justifies distinguishing between them and other participants. Applicant asserts that banks and bank holding companies are allegedly "unaffected by Rule G-37" because they may make contributions through divisions other than the municipal securities division. The important point which applicant overlooks is that the municipal securities division of a bank may not use the other divisions to make such contributions because that would be an indirect violation of the rule, prohibited by paragraph (d). It wa the Commission's judgment, pending experience with the rule, that this would be a sufficient safeguard. Approval Order at 42-44. Applicant asserts that the rule treats similarly situated individuals differently with regard to the exercise of fundamental speech and association rights and that the distinctions drawn by the rule must therefore be tailored to serve a substantial government interest. For the reasons given in discussing applicant's First Amendment Claims, we believe the rule passes muster under the equal protection clause as well. See 3 R. Rotunda and J. Nowak, Treaties on Constitutional Law: Substance and Procedure, section 18.40 (laws that survive substantive review under the specific guarantees of the First Amendment are also likely to be upheld under an equal protection analysis, for they have already been found to represent the promotion of governmental values which override the individual interest in the specific right).

2. Alleged Irreparable Harm and Likelihood of Success on the Merits a to Section (c) of the Rule, the Solicitation and Coordination Provision.

A. Irreparable Harm

Applicant's primary concerns appear to be with respect to the solicitation and coordination provision contained in Section (c) of the Rule. That provision prohibits affected persons from soliciting any person or political action committee to make any contribution, or from coordinating any contributions to officials of certain issuers. However, it only applies to issuers "with which the broker, dealer, or municipal securities dealer is engaging or is seeking to engage in municipal securities business" at the time of the solicitation or coordination.[14]

Beyond making the arguments discussed above, the applicant claims that his First Amendment rights will be impaired in numerous ways as a result of this provision. Many of these contentions simply overstate the scope of the provision. We reiterate our statement in our Preliminary Stay Order that we "construe[] the ban on solicitation narrowly as applying to explicit solicitations of contributions, and not to

---

[14] Thus, the provision is narrower than the business disqualification in that the disqualification applies for two years to any covered business over which an official to whom a contribution is made has influence. The solicitation and coordination provision arguably is broader than the business disqualification provision in that it contains no exception for official for whom the affected persons may vote.

generalized solicitations of support for a candidate or his views." Thus, applicant's concern that the provision could be triggered by inadvertently using the word "money" in a speech urging support for a candidate, or simply by making a speech of general support for a candidate, or simply by making a speech of general support at a fund-raising affair, is misplaced. Likewise, his contention that soliciting money for his political party will necessarily trigger the provision is incorrect. Soliciting money is prohibited only where the person making the solicitation knows that the funds will be directed by the party toward a specific official and his firm is engaged in or seeking to engage in municipal securities business with an issuer in which the official can influence the awarding of business.

We do not doubt, however, that some of applicant's activities could trigger this provision. To the extent that applicant knows he is soliciting money for specific candidates, rather than for the party in general, his activities would be covered. This may compel the applicant to give up some of his fund-raising activities or give up some of his municipal securities businesses. If as a result he must give up significant fund-raising activities, it is because the applicant has a significant conflict of interest. Simply put, by his own account he spends a substantial amount of time raising large sums of money which he then awards, in his discretion, to candidates for public office. He then seeks public contracts from those same officials. If the activities applicant must relinquish are greater than typical it is because his conflict of interest is more profound than is typical. The burden on him

is commensurate with the compelling public interest the provision weeks to address.[15]

We believe that this restraint on applicant's activities would constitute at most a marginal restraint on his ability to engage in expressive conduct. Applicant is not disabled from speaking in support of any official or candidate. He may speak at any time in support of any such person. He may make independent expenditures on behalf of the candidate. He may solicit money to be used for independent expenditures. All that he cannot do is solicit money on behalf of the candidate. Applicant fails to show how the act of soliciting money significantly expand on the message he can otherwise send. Just as a contribution of money is only a generalized expression of support, a solicitation of money by itself is no more than a generalized statement that this candidate is worthy of support, something he can readily state directly.

B. Likelihood of Success on the Merits

We do not believe that applicant has raised a sufficient question on the merits to warrant a stay. As we have construed the provision, it applies only to circumstances where a person is specifically soliciting contributions to an official and his firm is engaged or seeking to engage in

---

[15] Applicant could even have to step aside as party Chairman, if the job cannot be retailored and if he is unwilling to curtail some of the municipal securities business (limiting it, for example, to competitive underwriting and other competitive activities not covered by the rule). But a we noted above, applicant does not have a First Amendment right to be party chairman.

municipal securities business with an issuer in which the official can influence the awarding of business. Like the business disqualification provision discussed above, it addresses direct conflicts of interest. It does not preclude persons from expressing support for officials or urging that others support them. Applicant is left with his First Amendment rights intact. We believe that this restriction is justified by the compelling interest in eradicating conflicts of interest in the municipal securities business.

In disputing that, applicant claims that the solicitation and coordination provision is "unprecedented" as applied to a private citizen. This implicitly recognized that similar restrictions (in fact restrictions which are more onerous) have been upheld as imposed on federal and state employees.[16] The fact that solicitation bans have been upheld as to government employees indicates that such restrictions may be imposed if there is a sufficiently compelling public interest.

We do not believe that the problems we have identified can be eradicated through less restrictive means. We have discussed several of those mean above. Beyond that, we do not believe that the problem could be eradicated solely through the business disqualification provision. Although that provision is severable from the solicitation and coordination provision, the restriction on soliciting and coordinating contributions works to make the business contribution ban fully effective. If regulated persons can

---

16 See, e.g., United States Civil Service Commission v National Association of Letter Carriers, 413 U.S. 548, 555 (1973) (Among activities that can be prohibited is "actively participating in fund-raising activities for a partisan candidate or political party").

provide financial support to state and local officials by soliciting or coordinating contributions from others, the fact that they personally are prohibited from making contributions will be of considerably less significance.

3. Effect of a Stay of the Challenged Provisions on third Parties and the Public Interest

As to the remaining factors, we believe, for the reasons stated in the Preliminary Stay Order, that there could be substantial harm to municipal securities market participants and to the public interest if a stay of either provision were granted.

Conclusion

For the foregoing reasons, a stay of the Approval Order is not warranted with respect to sections (b), (c), or (d) of Rule G-37.

By the Commission.

Jonathan G. Katz
Secretary

/s/ Margaret H. McFarland
By: Margaret H. McFarland
Deputy Secretary

APPENDIX E

UNITED STATES COURT OF APPEALS

For the District of Columbia Circuit

No. 94-1336 **September Term, 1993**

William B. Blount,
Petitioner

[File stamp]
v. May 06 1994

Securities and Exchange Commission,
Respondent

BEFORE: Mikva, Chief Judge*; Edwards and Randolph, Circuit Judges

O R D E R

Upon consideration of the emergency motion for stay pending review, the responses thereto, and the reply; and the Municipal Securities Rulemaking Board's ("MSRB") motion for leave to intervene, it is

ORDERED that the motion for leave to intervene be granted. The Clerk is directed to file the lodged amended opposition to the emergency motion for stay. It is

FURTHER ORDERED that the emergency motion for stay be granted with respect to paragraph (c) of MSRB Rule G-37 and that portion of paragraph (d) insofar as it concerns the solicitation of contributions. This partial stay is granted only to the extent MSRB Rule G-37 applies to petitioners. With respect to the solicitation provisions, petitioner has satisfied the standards required for a stay pending court review. See Washington Metropolitan Area Transit Commission v. Holiday Tours, Inc., 559 F.2d 841 (D.C. Cir.

1977); D.C. Circuit Handbook of Practice and Internal Procedures 66-69 (1994). It is

FURTHER ORDERED that the motion for stay be denied with respect to paragraph (b) of MSRB Rule G-37 and that portion of paragraph (d) insofar as it concerns making contributions. With respect to the contribution provisions, petitioner has not demonstrated the requisite irreparable injury to warrant the issuance of a stay pending review. It is

FURTHER ORDERED, on the court's own motion, that the following briefing schedule shall apply:

Petitioner's Brief and Appendix	June 1, 1994
Respondent's Brief	July 1, 1994
Intervenor's Brief	July 18, 1994
Petitioner's Reply Brief	August 1, 1994

Oral argument will be heard at the earliest possible date following completion of the briefing.

Per Curiam

/s/ AJM
/s/ HTE
/s/ ARR

* Chief Judge Mikva would deny the emergency motion for stay in its entirety.

APPENDIX F

UNITED STATES COURT OF APPEALS
For the District of Columbia Circuit

No. 94-1336 **September Term, 1993**

William B. Blount,
Petitioner

v.

[File stamp]
OCT - 4 1995

Securities and Exchange Commission,
Respondent

Municipal Securities Rulemaking Board,
Intervenor

BEFORE: Williams, Henderson and Rogers, Circuit Judges

ORDER

Upon consideration of Petitioner's Petition for Rehearing filed September 18, 1995, it is

ORDERED that the petition be denied.

Per Curiam

FOR THE COURT:
Mark J. Langer, Clerk
By: /s/ Linda Jones
Linda Jones
Deputy Clerk

UNITED STATES COURT OF APPEALS
For the District of Columbia Circuit

No. 94-1336 **September Term, 1995**

William B. Blount,
Petitioner

v.

[File stamp]
OCT - 4 1995

Securities and Exchange Commission,
Respondent

Municipal Securities Rulemaking Board,
Intervenor

BEFORE: Edwards, Chief Judge, Wald, Silberman, Buckley, Williams, Ginsburg, Sentelle, Henderson, Randolph, Rogers, and Tatel, Circuit Judges

ORDER

Upon consideration of Petitioner's Suggestion for Rehearing In Banc, and the absence of a request by any member of the court for a vote, it is

ORDERED that the suggestion be denied.

Per Curiam

FOR THE COURT:
Mark J. Langer, Clerk
By: /s/ Linda Jones
Linda Jones
Deputy Clerk

APPENDIX G

STATUTORY AND REGULATORY PROVISIONS

15 U.S.C. § 78*o*-4 (in relevant part):

> (b) Municipal Securities Rulemaking Board; rules and regulations
>
> . . .
>
> (2) The Board shall propose and adopt rules to effect the purposes of this chapter with respect to transactions in municipal securities effected by brokers, dealers, and municipal securities dealers. (Such rules are hereinafter collectively referred to in this chapter as "rules of the Board".) The rules of the Board, as a minimum, shall:
>
> . . .
>
> (C) be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in municipal securities, to remove impediments to and perfect the mechanism of a free and open market in municipal securities, and, in general, to protect investors and the public interest; and not be designed to permit unfair discrimination between customers, issuers, municipal securities brokers, or municipal securities dealers, to fix minimum profits, to impose any schedule or fix rates of commissions, allowances, discounts, or other fees to be

charged by municipal securities brokers or municipal securities dealers, to regulate by virtue of any authority conferred by this chapter matters not related to the purposes of this chapter or the administration of the Board, or to impose any burden on competition not necessary or appropriate in furtherance of the purposes of this chapter.

15 U.S.C. § 78*s* (in relevant part):

Proposed rule changes; notice; proceedings

(b)(1) Each self-regulatory organization shall file with the Commission, in accordance with such rules as the Commission may prescribe, copies of any proposed rule or any proposed change in, addition to, or deletion from the rules of such self-regulatory organization (hereinafter in this subsection collectively referred to as a "proposed rule change") accompanied by a concise general statement of the basis and purpose of such proposed rule change. The Commission shall, upon the filing of any proposed rule change, publish notice thereof together with the terms of substance of the proposed rule change or a description of the subjects and issues involved. The Commission shall give interested persons an opportunity to submit written data, views, and arguments concerning such proposed rule change. No proposed rule change shall take effect unless approved by the Commission or otherwise permitted in accordance with the provisions of this subsection.

Rule G-37, which is reprinted in full at JA 644-50, provides in relevant part:

> (b) No broker, dealer or municipal securities dealer shall engage in municipal securities business with an issuer within two years after any contribution to an official of such issuer made by: (i) the broker, dealer or municipal securities dealer; (ii) any municipal finance professional associated with such broker, dealer or municipal securities dealer; (iii) any political action committee controlled by the broker, dealer or municipal securities dealer or by any municipal finance professional; provided, however, that this section shall not prohibit the broker, dealer or municipal securities dealer from engaging in municipal securities business with an issuer if the only contributions made by the persons and entities noted above to officials of such issuer within the previous two years were made by municipal finance professionals to officials of such issuer for whom the municipal finance professionals were entitled to vote and which contributions, in total, were not in excess of $250 by any municipal finance professional to each official of such issuer, per election.
>
> (c) No broker, dealer or municipal securities dealer or any municipal finance professional of the broker, dealer or municipal securities dealer shall solicit any person or political action committee to make any contribution, or shall coordinate any contributions to an official

of an issuer with which the broker, dealer or municipal securities dealers is engaging or is seeking to engage in municipal securities business.

(d) No broker, dealer or municipal securities dealer or any municipal finance professional shall, directly or indirectly, through or by any other person or means, do any act which would result in a violation of sections (b) or (c) of this rule.

Supreme Court, U.S.
FILED
MAR 1 1996
CLERK

(2)

No. 95-1063

IN THE
Supreme Court of the United States
OCTOBER TERM, 1995

WILLIAM B. BLOUNT,
Petitioner,
v.
SECURITIES AND EXCHANGE COMMISSION,
and
MUNICIPAL SECURITIES RULEMAKING BOARD,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

RESPONDENT MUNICIPAL SECURITIES RULEMAKING BOARD'S BRIEF IN OPPOSITION

DIANE G. KLINKE
General Counsel
MUNICIPAL SECURITIES
RULEMAKING BOARD
1150 18th Street, N.W.
Suite 400
Washington, D.C. 20036
(202) 223-9347

JOSEPH N. ONEK *
RICHARD J. MORVILLO
CLIFTON S. ELGARTEN
ALEXANDRE DE GRAMONT
CROWELL & MORING
1001 Pennsylvania Avenue, N.W.
Washington, D.C. 20004-2595
(202) 624-2500

* *Counsel of Record for Respondent Municipal Securities Rulemaking Board*

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

29 pp

QUESTIONS PRESENTED

1. Whether Municipal Securities Rulemaking Board Rule G-37, which prohibits those engaged in municipal securities business from doing business with issuers to whose officials they have made contributions, and from soliciting contributions for officials of issuers with whom they do or seek to do business, violates the First Amendment, when the Rule is narrowly tailored to curb the risk and appearance of corruption and coercion in the municipal securities industry, while leaving those in the municipal securities business free to engage in a vast array of political activities on behalf of these or any other officials, candidates, or causes.

2. Whether Municipal Securities Rulemaking Board Rule G-37, which does not regulate state or local elections but rather the conduct of persons and entities seeking to participate in interstate trade in municipal securities, violates the Tenth Amendment.

TABLE OF CONTENTS

	Page
TABLE OF AUTHORITIES	iv
COUNTERSTATEMENT	1
A. The MSRB	2
B. Pay-to-Play	4
C. Rule G-37	6
D. The Decision Below	8
REASONS FOR DENYING THE WRIT	11
I. THE DISTRICT OF COLUMBIA CIRCUIT'S DECISION IS ENTIRELY CONSISTENT WITH *BUCKLEY v. VALEO* AND THE COURT'S OTHER FIRST AMENDMENT PRECEDENT	12
II. THE DISTRICT OF COLUMBIA CIRCUIT PROPERLY REJECTED PETITIONER'S TENTH AMENDMENT CHALLENGE	22
CONCLUSION	24

TABLE OF AUTHORITIES

Cases: Page

Austin v. Michigan State Chamber of Commerce, 494 U.S. 652 (1990) 20
Blount v. SEC, 61 F.3d 938 (D.C. Cir. 1995) ..... *passim*
Broadrick v. Oklahoma, 413 U.S. 601 (1973) 18
Buckley v. Valeo, 424 U.S. 1 (1976) ..... *passim*
California Medical Ass'n v. FEC, 453 U.S. 182 (1981) 18
Carver v. Nixon, 72 F.3d 633 (8th Cir. 1995), *petition for cert. filed* (Feb. 7, 1996) 11
FEC v. Colorado Republican Campaign Comm., 59 F.3d 1015 (10th Cir. 1995), *cert. granted*, 116 S. Ct. 689 (Jan. 5, 1996) 11
FEC v. Massachusetts Citizens for Life, 479 U.S. 238 (1986) 18
FEC v. National Conservative Political Action Comm., 470 U.S. 480 (1985) 17, 18
FEC v. National Right to Work Comm., 459 U.S. 197 (1982) 12, 16, 17, 20
North American Co. v. SEC, 327 U.S. 686 (1946) .. 23
Oklahoma v. United States Civil Service Comm'n, 330 U.S. 127 (1947) 12, 18, 23
United States v. Boyle, 482 F.2d 755 (D.C. Cir.), *cert. denied*, 414 U.S. 1076 (1973) 17
United States v. Darby, 312 U.S. 100 (1941) 23
United States v. National Treasury Employees Union, 115 S. Ct. 1003 (1995) 14
United States Civil Service Comm'n v. National Ass'n of Letter Carriers, 413 U.S. 548 (1973) 12, 14, 17, 18

Constitutional Provisions, Statutes, and Rules:

First Amendment ..... *passim*
Tenth Amendment 2, 8, 10, 11, 22, 23
Federal Election Campaign Act of 1971, 2 U.S.C. §§ 431 *et seq.*
2 U.S.C. § 431 (17) 8
2 U.S.C. § 441b 17
2 U.S.C. § 441c 18
Hatch Political Activity Act, 5 U.S.C. §§ 1501 *et seq.* 12, 14, 18, 20, 21, 23

TABLE OF AUTHORITIES—Continued

	Page
Securities Exchange Act of 1934, 15 U.S.C. §§ 78b *et seq.*	
15 U.S.C. §§ 78c(a) (4), (5), and (30)	1
15 U.S.C. § 78c(a) (26)	3
15 U.S.C. § 78o-4(b)	2
15 U.S.C. § 78o-4(b) (2) (C)	3
15 U.S.C. § 78(s)	4
Municipal Securities Rulemaking Board Rule G-8	21
Municipal Securities Rulemaking Board Rule G-9	21
Municipal Securities Rulemaking Board Rule G-37	*passim*
Miscellaneous:	
Interview with William B. Blount, *Morning Edition* (National Public Radio, June 1, 1994), *available in* LEXIS, News Library, Transcript No. 1358-9	5
Politicians Are Mobilizing To Derail Ban on Muni Underwriters, *Wall Street Journal*, Dec. 17, 1993, at C16	13

IN THE

Supreme Court of the United States

OCTOBER TERM, 1995

No. 95-1063

WILLIAM B. BLOUNT,

Petitioner,

v.

SECURITIES AND EXCHANGE COMMISSION,

and

MUNICIPAL SECURITIES RULEMAKING BOARD,

Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

RESPONDENT MUNICIPAL SECURITIES RULEMAKING BOARD'S BRIEF IN OPPOSITION

COUNTERSTATEMENT

In recent years, there has been increasing concern that brokers, dealers, and municipal securities dealers (collectively, "dealers"),[1] along with municipal issuers, were involved in certain ethically questionable practices, known colloquially as "pay-to-play." Specifically, it was widely reported that dealers were able to enhance their prospects

[1] Under the Securities Exchange Act of 1934, "broker," "dealer," and "municipal securities dealer" all have particularized definitions, but in general refer to persons or entities engaged in the business of effecting securities transactions. *See* 15 U.S.C. §§ 78c(a)(4), (5), and (30).

of securing lucrative municipal securities contracts from government issuers by making campaign contributions to public officials of those issuers. More precisely defined, "pay-to-play" means that such campaign contributions are deemed a prerequisite to any serious consideration of the contributor to be awarded a given issuer's securities business. Although the contribution would not guarantee such business (because many potential dealers might make such contributions), it was a precondition—or at least an aid—in securing it.

To address the issues associated with pay-to-play, the Municipal Securities Rulemaking Board ("MSRB") proposed and filed Rule G-37 with the Securities and Exchange Commission ("SEC"), which the SEC ultimately approved. Rule G-37 generally prohibits those engaged in the municipal securities business from doing business for two years with issuers to whose officials they have made campaign contributions, and from soliciting such contributions for officials of issuers with whom they do or seek to do business.[2] A unanimous panel of the District of Columbia Circuit, in a thorough and well-reasoned decision authored by Judge Stephen F. Williams, concluded that Rule G-37 fell well within the permissible boundaries of this Court's First and Tenth Amendment precedent, and rejected petitioner's First and Tenth Amendment challenges to the Rule. *Blount v. SEC*, 61 F.3d 938 (D.C. Cir. 1995).

A. The MSRB

Congress established the MSRB in 1975 to develop rules for governance of the municipal securities industry. 15 U.S.C. § 78o-4(b). The MSRB is a not-for-profit, non-stock corporation, specifically designated as a "self-regulatory organization" under the Securities Exchange

---

[2] The Rule's definition of issuer officials specifically includes candidates for office of such issuers.

BEST AVAIL

Act of 1934.[3] The MSRB consists of fifteen members, ten of whom are themselves "associated with and representative of" municipal securities brokers and dealers. Five of the members are "public representatives" not associated with any municipal securities dealer. Those five must include at least one representative of investors in municipal securities, and one representative of municipal securities issuers (*e.g.*, state and local governments). *Id.* Because of its composition, the MSRB has an unusually well-balanced and realistic view of the issues affecting municipal securities markets and the conduct of dealers in those markets.

Congress specifically charged the MSRB with responsibility for developing rules to:

- Prevent fraudulent and manipulative acts and practices.
- Promote just and equitable principles of trade.
- Remove impediments to, and perfect the mechanism of, a free and open market in municipal securities.
- Protect investors and the public interest.

Id. at § 78o-4(b)(2)(C). Following this mandate, the MSRB has proposed, and the SEC has ultimately approved, rules governing the activities, obligations, and responsibilities of dealers, including the rule at issue in this case.

MSRB rules generally do not take effect unless and until the SEC approves them. Before submitting a rule to the SEC for approval, the MSRB typically provides a notice and comment period during which it receives and considers comments on the proposed rule, and revises the

---

[3] As defined by the Act, a "self-regulatory organization" is "any national securities exchange, registered securities association, or registered clearing agency," and specifically includes the MSRB. 15 U.S.C. § 78c(a)(26).

ABLE COPY

rule accordingly. Once the proposed rule is filed with the SEC, the SEC itself seeks comments. After considering the comments, the SEC will approve a proposed MSRB rule only if it concludes that the rule is consistent with the purposes of the Securities Exchange Act (*id.* at § 78(s)) and all other applicable law.

B. Pay-to-Play

Municipal securities are securities issued by states and their political subdivisions. They are generally employed to help finance a wide range of public projects, including roads, bridges, schools, hospitals, water and sewer projects, and countless other projects meant for the public good. Upon issuance, the securities are generally sold to dealers, who may then resell the securities to the public at a profit. The municipal securities market is enormous: there are 1.3 million municipal securities issues outstanding, with a value of over $1.2 trillion.

The municipal securities industry is unique in one respect. Municipal securities are, by definition, issued by government entities. This often means that the issuer's officials are subject to election, and thus subject to the economic pressures created by modern electoral politics. In the absence of regulation, dealers might well be in a position to provide substantial sums of money—through campaign contributions or solicitations—to the very government officials who will decide or who may influence the decision whether those dealers are to be awarded potentially lucrative municipal securities contracts.

The temptations on both sides are obvious. Government officials need campaign contributions to get to and stay in office. The dealer is seen as a source of funds and access to further sources of funds from other participants in the financial markets. For their part, dealers can profit greatly by securing the municipal securities contracts for certain municipal issues.

Historically, municipal financing contracts were awarded through a competitive bidding process, generally based on price. *SEC Approval Order* at Appendix to Petition ["App."] at B-6 and B-6 n.11. In recent years, however, more and more issuers have replaced the competitive bidding process with "negotiated underwritings," in which the issuer leaves itself with considerable leeway to choose the dealer based on subjective judgments. The process has fueled concern that dealers are being chosen *not* on the basis of price or merit, but rather based on other, "non-merits" considerations. *Id.* at App. B-6 to B-9. Hence, the concern with pay-to-play, wherein dealers must "pay" (*i.e.*, contribute or solicit contributions to political campaigns) in order to "play" (*i.e.*, to be considered for municipal securities business).

The idea that campaign contributions could influence the choice of dealer in this setting is as easily understood as it is pervasive. (Indeed, how could contributions *not* influence that choice?) Petitioner himself, a municipal bond dealer, candidly acknowledged the kind of linkage between well-placed contributions and the award of municipal securities business that the Rule is meant to combat: "most likely [state and local officials] are gonna call somebody who has been a political contributor" and award contracts to "friends" who have been contributors. Interview with William B. Blount, *Morning Edition* (National Public Radio, June 1, 1994), *available in* LEXIS, News Library, Transcript No. 1358-9; *see Blount*, 61 F.3d at 945.

Reports of pay-to-play practices burgeoned in the 1980's and early 1990's, with some dealers coming to regard pay-to-play as an ordinary cost of seeking business from certain municipal issuers. The integrity of the municipal securities market, and the integrity of the business practices used to obtain municipal securities business, were widely questioned. *SEC Approval Order* at App. at B-9 to B-13.

C. Rule G-37

Since 1990, the MSRB has monitored, considered, and publicly discussed the pay-to-play problem. While the MSRB initially urged industry members to voluntarily curb pay-to-play practices, it became increasingly convinced that a rule was necessary to adequately address the pay-to-play problem. In August 1993, MSRB published a draft rule on contributions. After revising the draft in light of some of the comments it received, the MSRB submitted Rule G-37 to the SEC, which in turn initiated its own notice and comment period in January 1994. On April 7, 1994, after the close of the comment period, the SEC issued an order approving the rule. (*See* App. B).

Petitioner challenges subsections (b) and (c) of the Rule. Subsection (b) bars any dealer from "engag[ing] in municipal securities business with an issuer within two years after any contribution to an official of such issuer made by" the dealer or by "any municipal finance professional asociated with" the dealer.[4] The two-year prohibition is not triggered, however, by total contributions of $250 or less per official per election to an official for whom the municipal finance professional is entitled to vote.

The MSRB added subsection (c) to the Rule after commentors observed that subsection (b)'s business prohibition could easily be evaded by soliciting or coordinating contributions for an official (a practice sometimes referred to as "bundling" contributions).[5] Subsection (c)

---

[4] Under Rule G-37, a "municipal finance professional" generally refers to an associated person who solicits, supervises, or engages in the dealer's municipal securities business. *See* Rule G-37(g)(iv). The Rule also bars the dealer from doing business with an issuer for a period of two years if a political action committee controlled by the dealer contributes to an official of that issuer (*id.* at (b)(iii)), although this provision of the rule is not at issue in this case.

[5] Petitioner's assertion that subsection (c) was added by the MSRB "as an afterthought . . . with no explanation whatsoever

therefore prohibits any dealer—and any municipal finance professional of the dealer—from soliciting or coordinating contributions for officials of any issuer with whom the dealer is "engaging or is seeking to engage in municipal securities business."[6]

In drafting and approving Rule G-37, the MSRB and SEC were sensitive to First Amendment concerns. *See SEC Approval Order* at App. B-34 to B-40. The Rule is limited in time, scope, and reach. It applies only to dealers and municipal finance professionals who do or seek to do business with the same issuers to whose officials they have made or solicited contributions. Even within that limited context, the Rule applies only to negotiated business; it does not apply to competitive bidding. *Id.* at B-18 n.41.

Moreover, the Rule applies *only* to the making or soliciting of campaign *contributions*—the giving of money directly to candidates or their campaigns. The Rule does *not* apply to *independent expenditures*—*i.e.*, expenditures in support of a candidate which are uncontrolled and uncoordinated by the candidate or campaign.[7] Thus, the

---

of the reason or need for it" (Petition at 5) is simply untrue. *See* MSRB Statement of the Purpose for the Proposed Rule Change, JA 652-53, 657. (JA refers to the Joint Appendix filed in the Court of Appeals and containing the record on review.)

[6] Subsections (b) and (c) are supplemented by subsection (d), a "loophole closing" provision which prohibits dealers from "directly or indirectly" doing anything that would "result in a violation of sections (b) or (c) . . . ." While petitioner mounted a "vagueness" challenge to subsection (d) in the Court of Appeals (*see* 61 F.3d at 948-49), he apparently abandons that challenge here. Subsections (b), (c), and (d) to Rule G-37 are set forth in their entirety in Appendix G to the Petition. The complete Rule is set forth at JA 644-50.

[7] *See Buckley v. Valeo*, 424 U.S. 1, 48-49 (1976). As defined by federal election law, an "independent expenditure" means "an expenditure by a person expressly advocating the election or defeat of a clearly identified candidate which is made without cooperation

Rule has no effect whatever on dealers' or municipal finance professionals' spending as much money as they want on behalf of any candidate, so long as the expenditures are not coordinated with or controlled by the candidate or campaign. Nor does the Rule limit the ability of dealers or municipal finance professionals to make speeches, attend fundraising events, or otherwise engage in the vast majority of political activities on behalf of the officials with whom they do business—or for that matter, on behalf of any other candidate or cause.

D. The Decision Below

Petitioner sought review of the SEC's order approving Rule G-37 in the United States Court of Appeals for the District of Columbia Circuit. On August 4, 1995, a unanimous panel of that court (Judge Williams, writing for himself, Judge Henderson and Judge Rogers) rejected petitioner's challenge after carefully considering each of petitioner's First and Tenth Amendment arguments (many of which are not repeated in the Petition to this Court). 61 F.3d 938.[8]

The court approached the First Amendment argument by analyzing Rule G-37 within the framework of this Court's well-established precedent for judging restrictions that affect the making and soliciting of campaign contributions, particularly as set forth in *Buckley v. Valeo*, 424 U.S. 1 (1976) and its progeny. It thus began by considering the level of First Amendment scrutiny to apply to Rule G-37. Finding no "clear-cut" guidance in this Court's cases on that issue, the court reasoned that "[i]f the rule can withstand strict scrutiny, there is no

---

or consultation with any canididate, or any authorized committee or agent of such candidate, and which is not made in concert with, or at the request or suggestion of, any candidate, or any authorized committee or agent of such candidate." 2 U.S.C. § 431(17).

[8] The circuit court rejected petitioner's petition for rehearing and suggestion for rehearing en banc on October 4, 1995.

need to decide the issue" (*id.* at 943); thus, the "level-of-scrutiny" issue was not resolved. Rather, following the paradigm for "strict scrutiny" review employed by this Court in similar cases, it held that the Rule survives even the strictest First Amendment scrutiny.[9]

First, the Court of Appeals recognized the governmental and regulatory interest furthered by Rule G-37—protecting the municipal securities industry from the risk and appearance of unfair and corrupt market practices—was both "substantial" and "compelling." *Id.* at 944.[10]

Second, the Court of Appeals held that "the provisions of Rule G-37 at issue can be expected materially to advance compelling interests asserted" by the government. *Id.* at 946. Specifically, the court found that in an industry in which dealers can make or solicit contributions to the same officials who decide whether to award them municipal securities business, the risk and appearance of both corruption and coercion is "obvious and substantial." *Id.* at 945. The court also recognized the obvious link between eliminating pay-to-play practices (under which dealers are considered for business not on the basis of merit, but based on the contributions they have made or solicited) and the goals of "perfecting the mechanism of a free and open market" and promoting "just and equitable principles of trade." *Id.*

---

[9] The MSRB believes that Rule G-37 does not focus on the content of speech and is thus not subject to strict scrutiny. However, MSRB also agrees with the Court of Appeals that since Rule G-37 survives strict as well as intermediate scrutiny, the issue is immaterial.

[10] The court found that a second interest proffered to support Rule G-37—protecting investors in municipal bonds from fraud—was also substantial and compelling. The court concluded, however, that the Rule did not sufficiently advance that interest to survive strict scrutiny. *See id.* at 945. While MSRB disagrees with this aspect of the court's ruling, it is immaterial for purposes of Blount's petition to this Court. The interest in market integrity identified by the court was clearly sufficient to justify the Rule.

Finally, the court held that Rule G-37 is narrowly tailored, *i.e.*, "closely drawn" and "avoid[s] unnecessary abridgement" of First Amendment rights. *Id.* at 947 (quoting *Buckley v. Valeo*, 424 U.S. at 25). The court rejected petitioner's argument that the Rule's solicitation provision was unnecessary. The court recognized that the Rule's business prohibition, standing alone, could easily be evaded by soliciting or coordinating contributions, thus necessitating restrictions on those activities. The court rejected petitioner's further argument that the Rule's goals could have been achieved through the less restrictive alternatives presented by disclosure requirements. The court held that disclosure and record-keeping alone would not provide an effective check in a situation where contributions are exchanged not for guaranteed business, but rather for the opportunity to be considered for business. *Id.* at 947.

The court found that Rule G-37 was limited in scope and effect. The Rule constrains relations only between the two potential parties to a *quid pro quo*: dealers on the one hand, and the officials who might influence the award of negotiated municipal securities contracts on the other. The Rule applies *only* to negotiated business (and not to competitive bid contracts), and even then restricts a narrow range of activities for a relatively short amount of time. *Id.* The court observed further that dealers and municipal finance professionals are "not in any way restricted from engaging in the vast majority of political activities, including making direct expenditures for the expression of their views, giving speeches, soliciting votes, writing books, or appearing at fundraising events." *Id.* at 948. Accordingly, the court held that Rule G-37 withstands even the strictest First Amendment scrutiny.

The Court of Appeals also rejected petitioner's Tenth Amendment claim that Rule G-37 usurps the power of States to control municipal or state elections. The court saw no basis for petitioner's effort to characterize the prohibitions as a federal agency effort to regulate local

elections: Rule G-37 is directed specifically at the conduct of persons who seek to participate in interstate trade in municipal securities. Nothing in the Tenth Amendment prohibits the federal government from regulating the conduct of private parties, irrespective of the fact that such conduct may affect local government (or local elections). That court thus concluded that petitioner's Tenth Amendment claim was "meritless." *Id.* at 949.

REASONS FOR DENYING THE WRIT

The petition raises neither a novel constitutional question nor an issue upon which the courts of appeal are divided. To the contrary, both the First Amendment and the Tenth Amendment arguments are foreclosed by long-standing precedent of this Court. In addition, this case is unrelated to *FEC v. Colorado Republican Campaign Committee*, 59 F.3d 1015 (10th Cir. 1995), *cert. granted*, 116 S. Ct. 689 (Jan. 5, 1996), which involves restrictions imposed by the Federal Election Campaign Act ("FECA") on *political party expenditures*, which are of course distinguished from limitations affecting contributions by individuals. Indeed, the Court in *Buckley v. Valeo* expressly reserved the question whether FECA's limitations on political party expenditures violated the First Amendment, while at the same time holding that FECA's limitations on individual contributions do not. 424 U.S. 1, 24-29, 59 n.69 (1976).[11]

---

[11] Nor is this case like *Carver v. Nixon*, 72 F.3d 633 (8th Cir. 1995), *petition for cert. filed* (Feb. 7, 1996). In *Carver*, the Eighth Circuit struck down a voter initiative imposing ceilings on individual campaign contributions which were lower than those provided for in an already existing (and still valid) statute. Whereas *Carver* involves direct and broad regulation of the electoral process for *all* citizens, Rule G-37 is a business regulation that applies only to those select individuals and entities which do or seek to do municipal securities business with issuers to whose officials they have made or solicited campaign contributions.

I. THE DISTRICT OF COLUMBIA CIRCUIT'S DECISION IS ENTIRELY CONSISTENT WITH *BUCKLEY v. VALEO* AND THE COURT'S OTHER FIRST AMENDMENT PRECEDENT.

1. There is nothing novel about governmental efforts to prevent corruption and corrupting practices—particularly, the potentially corrupting practices associated with giving money to decisionmakers—even though those practices arise in connection with political campaigns. Indeed, the Rule's restrictions are in all respects more modest and focused than many similar restrictions upheld by this Court, notwithstanding far more substantial and pervasive intrusions on First Amendment interests. In *Buckley v. Valeo*, the Court sustained the restrictions imposed by FECA on campaign *contributions* that *any* citizen may make in connection with federal elections, finding these to be warranted by the government's compelling need to avoid corruption, the appearance of corruption, and undue influence in connection with government action. The Court subsequently upheld FECA's restrictions on campaign *solictations* by corporations and labor unions.[12] And these types of restrictions have strong historic precedent in the federal government's absolute bar on contributions—along with gifts or gratuities to government officials—by those who seek government contracts. The Court has also upheld the Hatch Act's prohibition on federal employees—and state and local employees engaged in activities financed by federal funds—from taking *any* active part in political management or in political campaigns.[13] In sustaining such restrictions, this Court has reaffirmed that narrowly-tailored restrictions on participation in *certain* political campaign activities are justified by a compelling government interest

---

[12] *FEC v. National Right to Work Comm.*, 459 U.S. 197 (1982).

[13] *United States Civil Service Comm'n v. National Ass'n of Letter Carriers*, 413 U.S. 548 (1973); *Oklahoma v. United States Civil Service Comm'n*, 330 U.S. 127 (1947).

in preventing the risk and appearance of corruption or coercion.

2. "Pay-to-play" clearly poses the risk and appearance of corruption and coercion in the municipal securities market. First, there is *corruption*: *i.e.*, that government officials will choose dealers not for the quality or price of their services, but for the size of the campaign contributions they have made or solicited, undermining the basic market foundational principle of competition on the merits. Second, there is *coercion*: *i.e.*, when pay-to-play practices are viewed as prevalent throughout the market, dealers are necessarily pressured to make contributions to, or solicit contributions for, officials (even if they *disagree* with them politically) because of the belief that such contributions are a precondition to obtaining government business. Those dealers who succumb to that pressure necessarily have participated in a "tainted practice"—undermining the ethical standards of those dealers. If some dealers choose not to compete (believing that a distasteful contribution is a prerequisite to consideration) —or if some dealers choose not to contribute (and such a contribution is indeed a prerequisite to consideration) —there will be fewer competitors, and competition in the market will suffer. Each of these evils affects the market and undermines the ethical foundations upon which the market, and those competing within the market, should operate.

Once prevalent, such "pay-to-play" practices are difficult to curb voluntarily, for candidates may come to depend on contributions from dealers to finance their campaigns. Thus, voluntary efforts on the part of dealers to curb pay-to-play practices were reportedly met with threats of boycotts by municipal securities issuers. *See, e.g.*, "Politicians Are Mobilizing To Derail Ban on Muni Underwriters," *Wall Street Journal*, Dec. 17, 1993, at C16 (reporting that Florida Association of Counties called for boycott of 17 firms that had voluntarily banned political contributions).

3. The Rule eliminates, of course, the risk and appearance of impropriety inherent in the receipt of lucrative contracts from the offices of public officials to whose campaign coffers money has been given or solicited. On its face, G-37 eliminates the potential for a *quid pro quo* in the form of an award of government business in exchange either for a campaign contribution, or assistance in obtaining contributions. But there is more to "perfecting the mechanism of a free and open market" and "promoting just and equitable principles of trade" (*see Blount*, 61 F.3d at 945) than eliminating the explicit or implicit *quid pro quo*. Rule G-37 also eliminates the risk and appearance that more subtle, but equally insidious, forms of "influence" (*e.g.*, access and preferential treatment) will govern the placing of municipal securities business. By eliminating these more subtle forms of "influence," it reinforces both the reality, and the perception, that competition for municipal securities business is being conducted "on the merits."

Similar to the concerns underlying the Hatch Act, Rule G-37 also seeks to ensure that dealers are "free from pressure and from express and tacit invitations to . . . perform political chores in order to curry favor . . . ." *United States Civil Service Comm'n v. National Ass'n of Letter Carriers*, 413 U.S. 548, 566 (1973). The Rule also ensures that those dealers who would choose not to or be unable to make or solicit contributions are not thereby foreclosed from certain municipal securities business, which would dilute a fair, open, and competitive market.[14]

---

[14] In this respect, Rule G-37 *advances* First Amendment values by protecting dealers' "rights, notably their right to free expression, rather than restrict[ing] those rights." *United States v. National Treasury Employees Union*, 115 S. Ct. 1003, 1015 (1995). Protecting the First Amendment rights of dealers in this context is—for the reasons set forth above—perfectly consistent with protecting competition in the marketplace.

The Rule thus reinforces professional ethical standards of conduct by preventing dealers from benefitting from ethically questionable practices—or from being punished by declining to participate in such practices. It maintains honesty and integrity in the market and reaffirms the significant values associated with the belief that market forces—honest competition on the merits, rather than political influence—are and will be the guiding forces in the choice of dealers. There is a compelling government interest in all of these concerns.

4. While a Rule that touches upon political campaigns clearly has First Amendment implications, the Rule does not, of course, directly prohibit any First Amendment protected activity. Notwithstanding petitioner's effort to characterize the Rule as some sort of general effort by the SEC to regulate political campaigns (*see* Petition at 11), the Rule's focus is not on elections but on the municipal securities industry. At its core, it is an effort to monitor and supervise an interstate, commercial market. It thus prohibits dealers who have engaged in certain activities—albeit, activities with a First Amendment nexus, the giving of campaign contributions—from engaging in business with government entities where they might improperly benefit from what would otherwise be lawful, First Amendment protected activity.[15]

---

[15] The fact that the subject, purpose and focus of the restriction is commercial market activity does not, of course, totally remove the matter from First Amendment scrutiny. But this is not the type of sensitive case in which the government has purposefully intervened in the First Amendment "marketplace of ideas" in an effort somehow to correct or regulate the way that marketplace functions. Such efforts to meddle with the flow of ideas strike near the core of First Amendment concern; though, in connection with political contributions, some such efforts have been sustained. *E.g., Buckley*, 424 U.S. at 24-29. In cases like this, where the restriction in question is squarely premised on the need to regulate a commercial marketplace, rather than a direct governmental effort to tamper with the principle of free and open exchange of ideas, First Amendment concerns are less pronounced.

The First Amendment conduct upon which the Rule has an impact is solely the giving of money to, and soliciting of money for, public officials. Such conduct has long been understood as a proper subject of government regulation. As this Court has recognized, giving money directly to candidates, even for ostensibly political purposes, represents First Amendment activity of a particularly modest sort. *E.g.*, *Buckley*, 424 U.S. at 20-21; *FEC v. National Right to Work Comm.*, 459 U.S. 197, 206-08 (1982) ("*NRWC*"). The Rule's bar against doing business with an issuer is triggered only when the dealer (or one of its municipal finance professionals or political action cc ittees) has made contributions to an official of that And the solicitation prohibition applies only to th citation of contributions to officials of issuers with who the dealer does or seeks to do business. The dealer or municipal finance professional remains free to speak directly on any political issue, to use his or her money to disseminate his or her political views, or even to support the same political candidate through independent expenditures in support of the candidacy. The limitation arises solely from efforts to provide money directly to the candidate or official with whom the dealer does or seeks to do business. Petitioner does not, of course, suggest that the First Amendment shields from government scrutiny the giving of money to government officials for corrupt purposes. To the contrary, it has long been understood that where the giving of money to public officials is concerned, the boundary between benign political activity and ethically questionable activity is often difficult to identify, creating a role for government in establishing the ground rules. Rule G-37 follows a long line of First Amendment precedent allowing for curbs on the flow of money to political candidates to prevent corruption, the appearance of corruption, and corrupting and coercive influence.

Thus, in *Buckley*, the Court upheld as constitutional FECA's limits on individual contributions to candidates,

but struck down limitations on independent expenditures made by individuals. *See FEC v. National Conservative Political Action Comm.*, 470 U.S. 480, 491 (1985) (describing the *Buckley* holding). The Court in *Buckley* began its analysis by reaffirming the principle that " '[n]either the right to associate nor the right to participate in political activities is absolute.' " 424 U.S. at 25 (quoting *Letter Carriers*, 413 U.S. at 567). In upholding FECA's limitation on contributions,[16] the Court recognized that such limitations represent "*only a marginal restriction upon the contributor's ability to engage in free communication*," and that the limitations do "*not in any way infringe the contributor's freedom to discuss candidates and issues.*" *Id.* at 20-21 (emphasis added). The Court held that the "marginal restriction" represented by contribution limitations was justified by "the prevention of corruption and the appearance of corruption spawned by the real or imagined coercive influence of large financial contributions on candidates' positions and on their actions if elected to office." *Id.* at 25.

This Court has also upheld FECA's restrictions on corporations and labor unions from *soliciting* campaign contributions. *NRWC*, 459 U.S. 197.[17] In upholding these provisions, the Court recognized that like contributions themselves, soliciting and coordinating contributions represent a modest form of First Amendment activity, and that contributions and solicitations of contributions by these particular industries or entities pose special risks to the political process. *Id.* at 206-11.[18]

---

[16] The contribution restrictions prohibited individuals from contributing more than $25,000 in a single year or more than $1,000 to any single candidate for an election campaign. 424 U.S. at 13.

[17] Corporations and labor unions are prohibited from making contributions. The Act permits these entities to participate in limited soliciting, but only through a separate, segregated fund, established pursuant to and registered under FECA. *See* 2 U.S.C. § 441b.

[18] *See also United States v. Boyle*, 482 F.2d 755 (D.C. Cir.) (rejecting First Amendment challenge to FECA provisions regu-

The Court has also sustained the Hatch Act's total prohibition against federal employees—and against state and local employees engaged in activities financed in whole or in part by federal funds—from taking *any* part in political activities. *Letter Carriers*, 413 U.S. 548; *Oklahoma v. United States Civil Service Comm'n*, 330 U.S. 127 (1947). The Court held these provisions were justified both to ensure that government service "depend[s] upon meritorious performance rather than political service" (*Letter Carriers*, 413 U.S. at 557), and to protect government employees "from express or tacit invitation to . . . perform political chores in order to curry favor with their superiors rather than to act out their own beliefs . . . ." (*id.* at 566).[19]

5. Petitioner's effort to enlist *Buckley* in aid of his own cause does not withstand even the most superficial scrutiny. Petitioner bases his argument on that portion of *Buckley* which struck down FECA's limitations on *independent expenditures*, and all but ignores that portion of *Buckley* upholding FECA's restrictions on campaign *contributions*. *See* Petition at 11-13. This Court has consistently distinguished campaign contributions—which are controlled or coordinated by the candidate or campaign—from independent expenditures, which are not. The Court has just as consistently held that "restrictions on contributions require less compelling justification than restrictions on independent spending." *FEC v. Massachusetts Citizens for Life, Inc.*, 479 U.S. 238, 261 (1986) (citing *FEC v. National Conservative Political Action Comm.*, 470 U.S. 480 (1985); *California Medical Ass'n v. FEC*, 453 U.S. 182, 194, 196-97 (1981); *Buckley v. Valeo*,

---

lating political contributions by labor unions), *cert. denied*, 414 U.S. 1076 (1973). FECA also bans the making and soliciting of contributions by government contractors. 2 U.S.C. § 441c.

[19] All fifty states have restricted the political activities of their own employees. *See Broadrick v. Oklahoma*, 413 U.S. 601, 604 n.2 (1973) (rejecting First Amendment challenge to Oklahoma's bar against state employees soliciting campaign contributions).

424 U.S. at 20-22). And, consistent with *Buckley* and these other precedents, Rule G-37 imposes *no* restrictions whatsoever on independent expenditures (and only indirectly affects contributions). Petitioner's focus on that part of *Buckley* dealing with independent expenditures is therefore inexplicable.

6. Nothwithstanding petitioner's effort to characterize Rule G-37 as a broad First Amendment intrusion, the rule concerns itself only with a narrow issue: giving or soliciting money to candidates and public officials in a position to employ public office to influence the grant of particularized benefits—lucrative municipal securities contracts—to the giver. The Rule does not even limit the giving of money directly to candidates in connection with state and municipal elections, if the dealer is *not* seeking to obtain business from the states or localities of those candidates. Indeed, even where the dealer has given or solicited a contribution to a municipal official, the Rule is narrowly drawn to apply only to transactions in which the possibility of the contribution influencing a governmental decision to award a municipal securities contract is real and palpable: the Rule does not apply to contracts that are awarded through a competitive bid process.

More important, the Rule has no application to the expression of opinion on public issues by dealers or municipal finance professionals, including expressions of opinion on the issues in a municipal election. It in no way prevents them from speaking out about the candidates directly, publicly, forcefully and vigorously. It in no way prevents them from spending as much money as they want in support of particular issues, viewpoints or candidates (so long as the expenditures are neither controlled nor coordinated by the candidate or campaign). The Rule addresses the potential for corruption only with a particular form of action, giving money to or soliciting money for the candidate from whom business is sought.[20]

---

[20] Petitioner asserts that the Rule's restrictions affect "countless numbers of private citiens." Petition at 11. They do not. In

7. While conceding that the government would have an interest in punishing corrupt *quid pro quos*, petitioner argues that a prophylactic rule like this can only be justified by specific evidence that such *quid pro quo* arrangements are rampant in the municipal securities business. (Petitioner ignores the numerous complaints and reports concerning *quid pro quos* in the record.)

As recognized in *Buckley* and its progeny, however, the government may have a compelling interest in eliminating the *risk* and *appearance* of corruption through the adoption of sustainable *prophylactic* measures. To repeatedly assert (as petitioner does) that the record contains no hard evidence of specific *quid pro quos* is to misstate or misunderstand these precedents—as well as the purpose and justification of Rule G-37.

As the Court said of *quid pro quo* arrangements in *Buckley*, "the scope of such pernicious practices can never be reliably ascertained." 424 U.S. at 27. Thus, it is the "*potential*" for corruption "that demands regulation." *Austin v. Michigan State Chamber of Commerce*, 494 U.S. 652, 661 (1990) (emphasis added) (quoting *NRWC*, 459 U.S. at 209-10). The "*prevention* of corruption and the *appearance* of corruption spawned by the real *or imagined* coercive influence" of contributions are sufficient to warrant regulation. *Buckley*, 424 U.S. at 25 (emphasis added). Courts will not "second-guess a legislative determination as to the need for *prophylactic measures* where corruption is the evil feared." *NRWC*, 459 U.S. at 210 (emphasis added). *See also id.* at 208 (it is important to prevent "the eroding of public confidence . . . through *the appearance* of corruption") (emphasis added).

---

comparison to the FECA and Hatch Act restrictions sustained by this Court, Rule G-37's restrictions affect a very small number of people: dealers and municipal finance professionals seeking to do business with issuers to whose officials they have made or solicited contributions.

While the governmental interests supporting the contribution and solicitation restrictions of FECA and the Hatch Act are broad and general—the need to safeguard the political process as a whole against unspecified forms of undue influence and political corruption—the governmental interest supporting Rule G-37 is quite narrow and specific. It is tied to the special relationship between dealers and issuer officials, where, in the absence of regulations, these dealers can do or seek to do business with the same officials to whom they have made direct payments in the form of campaign contributions, or for whom they have solicited contributions. (In other settings, similar conduct might be regarded as a "kickback.") The risk and appearance of corruption are clearly inherent in that relationship.

8. Petitioner's argument that even if the business prohibition is necessary, the solicitation restriction is not, was also properly rejected by the District of Columbia Circuit. As both commentors to the MSRB's original draft rule and the District of Columbia Circuit recognized, the business prohibition would be easily evaded if dealers or their municipal finance professionals could simply solicit or coordinate contributions instead. *See Blount*, 61 F.3d at 947. Not unlike FECA's "total" contribution limits, the solicitation prohibition "serves to prevent evasion" of the contribution restrictions by a person who is in the position to solicit or coordinate the giving of "massive amounts of money to a particular candidate . . . ." *Cf. Buckley*, 424 U.S. at 38.

9. Finally, the District of Columbia Circuit properly rejected petitioner's argument that there are less restrictive means available to further Rule G-37's goals—specifically the disclosure and record-keeping requirements instituted in Rule G-37(e) and Rules G-8 and G-9. As in *Buckley*, the government "was surely entitled to conclude that disclosure was only a partial measure." 424 U.S. at 28. Disclosure and record-keeping are especially unlikely to protect the market from the risk and appear-

ance of corruption within the specific context of pay-to-play. This is because in pay-to-play, contributions or solicitations are not exchanged for guaranteed business, but merely for being considered for business (thus making it difficult to specifically link the *quid* to the *quo; see Blount*, 61 F.3d at 945). Indeed, in the absence of contribution and solicitation provisions, disclosure may actually make the pay-to-play situation worse: in a regime where dealers believe they have to give or solicit contributions to be considered for business, disclosures of which dealer gave how much money to whom is likely to spur competition of the most unseemly kind, where one dealer tries to "one-up" the next by giving or soliciting more.

In sum, the District of Columbia Circuit properly applied this Court's well-established precedent in concluding that Rule G-37's indirect effect on the extent to which dealers will make or solicit contributions does not impermissibly infringe upon First Amendment rights. There is no need for this Court to revisit that determination.

II. THE DISTRICT OF COLUMBIA CIRCUIT PROPERLY REJECTED PETITIONER'S TENTH AMENDMENT CHALLENGE.

Petitioner's argument that Rule G-37 violates the Tenth Amendment is thus premised on a fundamental misconception of what Rule G-37 does. As the Court of Appeals recognized, Rule G-37 does what all MSRB rules do and are supposed to do: they regulate the activities of dealers engaged in interstate commerce. That the Rule has an ancillary effect on state and local elections is insufficient to implicate the Tenth Amendment. Countless federal regulations indirectly affect states and localities—and any regulation of the market in municipal securities has an impact on municipal governments. But this does not mean they encroach on the powers of *state government* in a way that violates the Tenth Amendment.

BEST AVAILA

In *Oklahoma v. United States Civil Service Commission*, 330 U.S. 127, 142-44 (1947), this Court rejected a Tenth Amendment (as well as a First Amendment) challenge to that part of the Hatch Act which precludes state and local officials employed in activity funded in whole or in part by the United States from participating in any political activities. The Court held that "[w]hile the United States is not concerned with, and has no power to regulate, local political activities as such of state officials, it does have power to fix the terms upon which its money allotments to states shall be distributed." *Id.* at 143. The Court continued: "the Tenth Amendment has consistently been construed 'as not depriving the national government of authority to resort to all means for the exercise of a granted power which are appropriate and plainly adapted to the permitted end.'" *Id.* (quoting *United States v. Darby*, 312 U.S. 100, 124 (1941)).

Even more clearly, the federal government has the power to fix the terms on which dealers engaged in interstate commerce conduct their business. In the words of the Court of Appeals, petitioner "points to no theory of the Tenth Amendment or the commerce clause under which Congress [or an agency acting at the direction of Congress, *see, e.g., North American Co. v. SEC*, 327 U.S. 686 (1946)] is disabled from regulating private persons in their conduct of interstate trade in municipal securities." *Blount*, 61 F.3d 949.

BLE COPY

CONCLUSION

For the foregoing reasons, the MSRB respectfully submits that the Petition should be denied.

Respectfully submitted,

DIANE G. KLINKE
General Counsel
MUNICIPAL SECURITIES
RULEMAKING BOARD
1150 18th Street, N.W.
Suite 400
Washington, D.C. 20036
(202) 223-9347

JOSEPH N. ONEK *
RICHARD J. MORVILLO
CLIFTON S. ELGARTEN
ALEXANDRE DE GRAMONT
CROWELL & MORING
1001 Pennsylvania Avenue, N.W.
Washington, D.C. 20004-2595
(202) 624-2500

* *Counsel of Record for Respondent Municipal Securities Rulemaking Board*

March 4, 1996

(3)

Supreme Court, U.S.
FILED
MAR 4 1996
CLERK

No. 95-1063

In the Supreme Court of the United States

OCTOBER TERM, 1995

WILLIAM B. BLOUNT, PETITIONER

v.

SECURITIES AND EXCHANGE COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION

DREW S. DAYS, III
Solicitor General
Department of Justice
Washington, D.C. 20530
(202) 514-2217

RICHARD H. WALKER
General Counsel

PAUL GONSON
Solicitor

JACOB H. STILLMAN
Associate General Counsel

ERIC SUMMERGRAD
Principal Assistant General Counsel

MARK PENNINGTON
Senior Litigation Counsel
Securities and Exchange Commission
Washington, D.C. 20549

26 pp

QUESTIONS PRESENTED

1. Whether Municipal Securities Rulemaking Board Rule G-37, which restricts the ability of municipal securities dealers to engage in certain types of municipal securities business if they make campaign contributions to (or solicit or coordinate contributions on behalf of) state and local officials who can influence the award of that business, violates the First Amendment rights of municipal securities dealers.

2. Whether the Rule's restrictions impermissibly intrude upon the power of the States to control their own elections, in violation of the Tenth Amendment.

TABLE OF CONTENTS

	Page
Opinions below	1
Jurisdiction	1
Statement	2
Argument	11
Conclusion	21

TABLE OF AUTHORITIES

Cases:

Atascadero State Hospital v. *Scanlon*, 473 U.S. 234 (1985)	20
Buckley v. *Valeo*, 424 U.S. 1 (1976)	12, 13, 14, 15, 17, 18
Carver v. *Nixon*, 72 F.3d 633 (8th Cir. 1995), pet. for cert. pending, No. 95-1258	16
FEC v. *Colorado Republican Campaign Comm.*, 59 F.3d 1015 (10th Cir. 1995), cert. granted, 116 S. Ct. 689 (1996)	19
FEC v. *National Conservative Political Action Comm.*, 470 U.S. 480 (1985)	12
FEC v. *National Right to Work Comm.*, 459 U.S. 197 (1982)	13, 15
Garcia v. *San Antonio Metropolitan Transit Authority*, 469 U.S. 528 (1985)	11
Gregory v. *Ashcroft*, 501 U.S. 452 (1991)	19-20
New York v. *United States*, 505 U.S. 144 (1992)	11
Skinner v. *Railway Labor Executives' Ass'n*, 489 U.S. 602 (1989)	16
United States Civil Serv. Comm'n v. *National Ass'n of Letter Carriers*, 413 U.S. 548 (1973)	13
United States v. *Naftalin*, 441 U.S. 768 (1979)	14

Constitution, statutes and regulations:

U.S. Const.:	
Amend. I	2, 7, 12
Amend. X	2, 8, 10, 11, 19, 20

Statutes and regulations—Continued: Page

Age Discrimination in Employment Act of 1967, 29 U.S.C. 621-634 (1988 & Supp. V 1993) 20
Securities Exchange Act of 1934, 15 U.S.C. 78a *et seq.*:
§ 3(a)(4), 15 U.S.C. 78c(a)(4) 4
§ 3(a)(5), 15 U.S.C. 78c(a)(5) 4
§ 3(a)(29), 15 U.S.C. 78c(a)(29) 3
§ 3(a)(30), 15 U.S.C. 78c(a)(30) 4
§ 15(a)(1), 15 U.S.C. 78*o*(a)(1) 3
§ 15B(a), 15 U.S.C. 78*o*-4(a) 3
§ 15B(b), 15 U.S.C. 78*o*-4(b) 3
§ 15B(b)(2), 15 U.S.C. 78*o*-4(b)(2) 2
§ 15B(b)(2)(C), 15 U.S.C. 78*o*-4(b)(2)(C) 3
§ 15B(c)(1), 15 U.S.C. 78*o*-4(c)(1) 3
§ 19(b), 15 U.S.C. 78s(b) (1988 & Supp. V 1993) .. 5
§ 25, 15 U.S.C. 78y (1988 & Supp. V 1993)..... 7, 11
§ 27, 15 U.S.C. 78aa 11
2 U.S.C. 431(17) 18
2 U.S.C. 441c (a)(1) 18
2 U.S.C. 441c (a)(2) 18
Ariz. Rev. Stat. Ann. (1995):
§ 16-919 18
§ 16-921(B) 18
Conn. Gen. Stat. Ann. § 9-333*o*(a) (West 1995) 18
1995 Ct. ALS 188 (to be codified at Conn. Gen. Stat. Ann. § 1-84(n)) 18
N.D. Cent. Code (1991):
§ 16.1-08-01(10) 18
§ 16.1-08-02(1) 18
Pa. Stat. Ann. tit. 25 § 3253 (1994)..... 18
S.D. Codified Laws Ann. § 12-25-2 (1995)..... 18
W. Va. Code:
§ 3-8-8 (1994)..... 18
§ 3-8-12(d) (1995)..... 18
§ 3-8-12(h) (1995)..... 18
Wis. Stat. Ann. (West 1986 & Supp. 1995):
§ 11.29 18
§ 11.38 18
Wyo. Stat. § 22-25-102 (1992)..... 18

Regulations—Continued: Page

11 C.F.R. 115.2 18
Fla. Admin. Code Ann. r.:
9I-16.004(e) 18-19
19A-6.004 18

Miscellaneous:

Morning Edition: SEC Halts Political Campaign Funding from Wall Street (National Public Radio Broadcast, June 1, 1994) 15
Securities Acts Amendments of 1975: Report of the Committee on Banking, Housing, and Urban Affairs, to Accompany S. 249, S. Rep. No. 75, 94th Cong., 1st Sess. (1975) 3

In the Supreme Court of the United States

OCTOBER TERM, 1995

No. 95-1063

WILLIAM B. BLOUNT, PETITIONER

v.

SECURITIES AND EXCHANGE COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A1-A27) is reported at 61 F.3d 938. The order of the Securities and Exchange Commission approving Municipal Securities Rulemaking Board Rule G-37 (Pet. App. B1-B60) is reported at 56 SEC Docket 1045.

JURISDICTION

The judgment of the court of appeals was entered on August 4, 1995, and a petition for rehearing was denied on October 4, 1995 (Pet. App. F1). The petition for a writ of certiorari was filed on January 2, 1996. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

Petitioner seeks review of the court of appeals' judgment upholding the Securities and Exchange Commission's decision approving Municipal Securities Rulemaking Board (MSRB) Rule G-37. The Rule is aimed at ending the widespread practice colloquially known as "pay-to-play." That practice involves securities dealers' making of campaign contributions to officials of state and local issuers of municipal securities in return for being considered for, or awarded, municipal securities business. When pay-to-play prevails, business is awarded on the basis of political influence rather than merit, and the market for municipal securities is distorted and corrupted.

Rule G-37 restricts the ability of dealers to do business with issuers when the dealer or certain of its employees have given contributions to, or solicited or coordinated contributions for, issuer officials who can influence the award of municipal securities business. Petitioner contends that the Rule violates his First Amendment rights, and impinges on state authority over elections in violation of the Tenth Amendment.

1. The Securities and Exchange Commission and the MSRB, among others, regulate the market for municipal securities. The MSRB is the self-regulatory organization established by Congress to propose and adopt rules governing the operations of municipal securities dealers. 15 U.S.C. 78*o*-4(b)(2). Those rules do not become effective unless approved by an order of the Commission. The MSRB is specifically charged with making rules to prevent fraudulent and manipulative acts and practices, to help perfect the mechanism of a free and open market, and to promote just

and equitable principles of trade. 15 U.S.C. 78*o*-4(b)(2)(C). As the Commission observed, Congress created the MSRB and gave it and the Commission rulemaking authority in large measure because Congress believed "that the lack of federal regulation * * * represents a serious threat to the integrity of the capital-raising system upon which local governments rely to finance their efforts." Pet. App. B28 n.53 (quoting *Securities Acts Amendments of 1975: Report of the Committee on Banking, Housing, and Urban Affairs, to Accompany S. 249*, S. Rep. No. 75, 94th Cong., 1st Sess. 38 (1975)). Dealers must be registered with the Commission and must conduct their business in compliance with the rules of the MSRB. See Securities Exchange Act of 1934, §§ 15(a)(1), 15B(a), (b) and (c)(1); 15 U.S.C. 78*o*(a)(1), 78*o*-4(a), (b) and (c)(1).

Municipal securities are, generally speaking, obligations of States and their political subdivisions or instrumentalities. Securities Exchange Act § 3(a)(29), 15 U.S.C. 78c(a)(29). There are approximately 1.3 million municipal securities issues outstanding, with a total value of more than $1.2 trillion; in 1993 alone, there were 17,000 new issues, with a face value of $335 billion. Pet. App. B4-B5. Approximately 70% of those securities are held by or on behalf of members of the public, either individually or through mutual or money market funds. *Id.* at B3.

Municipal securities are typically sold by the issuer to dealers, who act as underwriters and expect to resell the securities to the investing public at a profit. See generally Pet. App. B5-B9.[1] "Under-

---

[1] Rule G-37 applies to "broker[s]," "dealer[s]" and "municipal securities dealer[s]," as those terms are defined in Sections

writers perform essential functions in offerings by structuring the offering and preparing disclosure documents that form the basis of marketing the offering to the public." *Id.* at B28. Underwriters are required to have a reasonable basis for recommending securities and must review professionally the accuracy of statements made in offering documents. *Id.* at B28 n.54.

Historically, most issuers selected dealers through competitive bidding. In recent years, however, negotiated underwritings, in which the dealer is selected by the issuer without competitive bidding, have become more common, and as of 1993 they comprised 80% of all underwritings. Pet. App. B5-B9. Negotiated underwritings present a far greater opportunity than do competitive underwritings for consideration of non-objective, non-merit based criteria, and therefore "present greater risk of abuse in the underwriter selection process." *Id.* at B8 (footnote omitted). The most widespread potential for abuse is presented by pay-to-play. Complaints about pay-to-play have received considerable attention from Congress, the Commission, the MSRB, the securities industry, the media and the public, "reflecting concerns regarding the integrity, fairness, and sound operation of the municipal securities market." *Id.* at B9-B12; see C.A. App. 1384-1483 (press reports reviewed by Commission).

2. The MSRB proposed Rule G-37 as a means of eliminating pay-to-play, and the Commission gave the

---

3(a)(4), (5), and (30) of the Securities Exchange Act of 1934, 15 U.S.C. 78c(a)(4), (5) and (30). References herein to "dealers" or "underwriters" encompass brokers, dealers, and municipal securities dealers.

approval required by Section 19(b) of the Securities Exchange Act, 15 U.S.C. 78s(b) (1988 & Supp. V 1993), for the Rule to become effective. Petitioner challenges sections (b) and (c) of the Rule, which are designed to sever the link between the award of municipal securities business and the making or soliciting of campaign contributions. Pet. App. A3-A4, G3-G4.[2]

Section (b) imposes a limitation on the business activities of dealers who make certain campaign contributions. It provides, in part:

> No broker, dealer or municipal securities dealer shall engage in municipal securities business with an issuer within two years after any contribution to an official of such issuer * * *.

See Pet. App. G3-G4; C.A. App. 644-650 (reprinting Rule). Section (b) includes an exception, however, allowing municipal finance professionals (*i.e.*, certain employees of municipal securities dealers) to contribute not more than $250 per candidate, per election, to candidates for whom they are entitled to vote.[3]

---

[2] Section (a) of Rule G-37 states the Rule's purpose and intent. Section (d) is a "loophole closer," providing that no dealer or municipal finance professional shall, directly or indirectly, through or by any other person or means, do any act that would result in a violation of section (b) or (c) of the Rule. Sections (e) and (f) contain disclosure provisions. No sections other than (b) and (c) are at issue here. See Pet. i, 6 n.6.

[3] The exemption is limited to candidates for whom the professional is entitled to vote because, "[a]lthough an individual may have a legitimate interest in making contributions to candidates for whom she is ineligible to vote, there is a greater risk in such circumstances that the contribution is motivated by

Section (g)(vii) defines "municipal securities business" generally to exclude business done on a competitive bid basis. C.A. App. 648.[4]

Section (c) provides that no dealer

> shall solicit any person or political action committee to make any contribution, or shall coordinate any contributions to an official of an issuer with which the [dealer] is engaging or is seeking to engage in municipal securities business.

Pet. App. G3-G4.

In approving Rule G-37, the Commission found that the widespread existence of pay-to-play "substantially undermine[s] the integrity of the municipal securities market." Pet. App. B3. Pay-to-play may result in business being awarded to dealers "based on their history of contributions or political contacts, rather than their expertise or competence." *Id.* at B29. The Commission concluded that pay-to-play interferes with the mechanism of a free and open market because it raises artificial barriers to competition for those firms that either cannot afford or decide not to make political contributions. *Id.* at B32. The practice is contrary to just and equitable principles of trade

---

an improper attempt to influence municipal officials." Pet. App. B53.

[4] Section (b) treats contributions by municipal finance professionals associated with a dealer, as well as contributions by any political action committee that the dealer controls, as equivalent to contributions by the dealer itself. Section (g)(vi) defines an official of an issuer as anyone who, at the time of the contribution, was an incumbent, candidate or successful candidate for either an elective office of the issuer that has authority to hire or influence the hiring of dealers, or an elective office with authority to appoint such an issuer official. C.A. App. 648.

because dealers may receive different rewards for doing the same work, based on whether they made political contributions. *Id.* at B33.

The Commission also noted the risks pay-to-play imposes on investors, because an underwriter selected on the basis of political contributions rather than on merit alone may fail to carry out its obligations fully to investigate and disclose the creditworthiness of the issuer, either because political considerations compromise the underwriter's ability to investigate the issuer objectively, or because it is not competent. Pet. App. B28-B30. And pay-to-play causes an appearance of corruption: opportunities for political influence in underwriter selection create the appearance of conflicts of interest between the underwriter's obligations to its investor customers and its allegiance to the issuer official who selected the underwriter. *Id.* at B30-B31. The Commission concluded that that perception undermines public confidence in the integrity of the market.

3. a. Petitioner was until recently Chairman of the Alabama Democratic Party, in which capacity he raised and distributed campaign funds for state and local officials; he was at the same time a municipal securities dealer, in which capacity he approached state and local officials in Alabama, seeking and obtaining municipal securities business for his firm. Pet. App. A4, D3-D4. On April 26, 1994, petitioner sought judicial review, pursuant to 15 U.S.C. 78y (1988 & Supp. V 1993), of the Commission's decision to approve the Rule. Petitioner claimed that by forcing him to choose between making (or soliciting) political contributions and engaging in certain municipal securities business, the Rule unconstitutionally impairs his First Amendment rights. Petitioner also

asserted that the Rule impermissibly interferes with the power of the States to control their own elections, in violation of the Tenth Amendment.

b. The court of appeals unanimously rejected each of petitioner's challenges and denied the petition. Pet. App. A1-A27. The court denied rehearing, with no judge requesting a vote on the suggestion of rehearing en banc. *Id.* at F1-F2.

The court of appeals assumed without deciding that strict constitutional scrutiny applies, and held that Rule G-37 withstands such scrutiny because the Rule is narrowly tailored to advance the compelling governmental interest of protecting the integrity of the municipal bond market. Pet. App. A13-A24.[5] The court of appeals found compelling the interests in "(1) protecting investors in municipal bonds from fraud and (2) protecting underwriters of municipal bonds from unfair, corrupt market practices," reasoning that the interest in "clean bond markets" is as strong as the interest in "clean elections" that this Court repeatedly has held to be compelling. *Id.* at A14 (citing cases). The court explained: "one of the primary reasons people object to bought elections is that a bought politician tends to make distorted choices, and the public's concern about a particular type of

---

[5] The court observed that the Commission approved the Rule solely for "the purpose of preventing corrupt bond markets"—a purpose that "might logically be considered unrelated to the suppression of speech" and thus warrant intermediate rather than strict scrutiny. Pet. App. A12. But the court of appeals concluded that, in the absence of definitive guidance as to whether an anti-corruption goal is content-based, the Rule should be analyzed under strict scrutiny. *Id.* at A8-A13. In this brief, we shall proceed on that assumption, without foreclosing the applicability of intermediate scrutiny.

distorted choice (the choice of bond underwriter) does not logically stand on a lower plane than its concern about bought politicians generally." *Ibid.*

The court rejected petitioner's contention that Rule G-37 does not serve the interests the Commission asserted. Pet. App. A15-A21. It concluded that the need for Rule G-37 had been adequately demonstrated: "[U]nderwriters' campaign contributions self-evidently create a conflict of interest in state and local officials who have power over municipal securities contracts and a risk that they will award the contracts on the basis of benefit to their campaign chests rather than to the governmental entity." *Id.* at A15. The court noted that petitioner's own statements in a radio interview drew a connection between campaign contributions and the award of municipal bond business, *id.* at A15-A16, and that the Commission had before it information on "[s]pecific abuses [that] have been alleged in several state and local governments," *id.* at A16 (quoting *SEC Approval Order* at 8-11 (Pet. App. B9-B12)). The court further concluded that Rule G-37 advances "the Commission's goals of 'perfecting the mechanism of a free and open market' and promoting 'just and equitable principles of trade'" by eliminating artificial barriers to competition and assuring an equitable allocation of underwriting assignments. Pet. App. A17-A18.[6]

---

[6] Although the court understood that Rule G-37 serves the Commission's interest in protecting the municipal securities market from corruption, it did not believe that the Rule similarly serves the Commission's interest in protecting investors. In the court's view, dealers' existing interests in avoiding fraud liability and safeguarding their own reputations adequately protect the investing public, and "[n]either interest

Finally, the court held that Rule G-37 is narrowly tailored to further the interests it identified. Pet. App. A21-A24. Rule G-37 is "closely drawn" to "constrain[] relations only between the two potential parties to a quid pro quo," and, "[e]ven then, the rule restricts a narrow range of their activities for a relatively short period of time." *Id.* at A22-A23. The court noted that the Rule applies only to negotiated and not to competitively bid underwriting business. *Id.* at A22 n.5. Section (b) bars a dealer from seeking or doing business with an issuer only for two years following its contribution to officials of that issuer, and section (c) bars such activity only during the time that the dealer is soliciting or coordinating contributions for those officials. Rule G-37 also does not restrict municipal finance professionals from "the vast majority of political activities, including making direct expenditures for the expression of their views, giving speeches, soliciting votes, writing books, or appearing at fundraising events." *Id.* at A23. The court rejected petitioner's contention that less restrictive alternatives, such as exclusive reliance on the Rule's unchallenged disclosure provisions, would suffice, and concluded that "none of the alternatives presented would be even *almost* equally effective." *Id.* at A21-A22.

Petitioner's Tenth Amendment challenge was, in the court of appeals' view, "meritless," because Rule G-37 does not regulate States directly and does not compel States to regulate private parties. Pet. App.

---

would be diminished merely by an underwriter's use of sleazy means to secure the contract." Pet. App. A17. The court concluded, however, that the interest in protecting the market sufficed to support the Rule. *Id.* at A15-A21.

A26 (citing *New York* v. *United States*, 505 U.S. 144 (1992)). Rather, it regulates "private persons in their conduct of interstate trade in municipal securities." Pet. App. A26. In these circumstances, the court concluded, Rule G-37 "does not have anything resembling the kind of preemptive effect on States' ability to control their own election processes that might be perceived as 'destructive of state sovereignty.'" *Ibid.* (quoting *Garcia* v. *San Antonio Metropolitan Transit Authority*, 469 U.S. 528, 554 (1985)).

ARGUMENT

Rule G-37 is a narrowly drawn provision aimed at eradicating the well recognized corruption that pay-to-play practices bring to the municipal securities market. The constraints the Rule places on the expression-related activities of certain regulated securities professionals are carefully limited, and are justified by the compelling goals it serves. Rule G-37 restricts the activities of private individuals, not of States, and thus does not implicate Tenth Amendment concerns. The decision below upholding the Rule is correct and neither raises important unresolved issues, nor conflicts with any decision of this Court or any other court of appeals.[7]

1. The centerpiece of petitioner's argument is that Rule G-37 imposes unjustified restraints on munici-

---

[7] A constitutional challenge to a MSRB rule may be raised not only, as here, on judicial review of the Commission's decision to approve the rule, but also, where appropriate, in an action to enforce the Rule. An appeal in such an action could be heard by a court of appeals other than the Court of Appeals for the District of Columbia Circuit. See 15 U.S.C. 78y (1988 & Supp. V 1993), 78aa.

pal securities dealers' rights to express themselves in the political arena. Pet. 10. The Rule's restrictions are, however, supported by this Court's decisions regarding campaign contribution and solicitation, including *Buckley* v. *Valeo*, 424 U.S. 1 (1976), which upheld against a First Amendment challenge campaign contribution limits substantially broader than those at issue here.

a. The Rule's modest restraints on expression and association are, as the court of appeals correctly held, justified by the compelling need to cleanse the municipal securities market of political favoritism. As the Commission and the court of appeals found, the corruption arising from pay-to-play distorts the municipal securities market because it results in business being awarded based on political contributions rather than market forces driven by factors such as cost and quality of dealers' service. By effectively requiring political contributions from dealers seeking to act as municipal securities underwriters, and channelling business to large contributors, pay-to-play interferes with the fairness of the enormous and vitally important market for municipal securities.

Preventing corruption and the appearance of corruption have been repeatedly recognized as interests sufficiently compelling to justify appropriate restrictions on First Amendment interests. See, *e.g.*, *FEC* v. *National Conservative Political Action Comm.*, 470 U.S. 480, 496-497 (1985); *Buckley*, 424 U.S. at 25-27, 30. Contributions that are given to secure a *quid pro quo* in terms of municipal securities business from current and potential office holders undermine the integrity and competitive character of the municipal securities market.

Buckley's reasoning regarding campaign contributions also applies to solicitation and coordination activities. Section (c) is a prophylactic rule serving the same purpose as section (b). Section (c) prohibits dealers and municipal finance professionals from soliciting or coordinating contributions to specified officials of issuers with which the dealer is at that time engaging, or seeking to engage, in municipal securities business. The value of solicitation of contributions to a candidate may often essentially equal the value of direct contributions, because in both instances the candidate receives funds that he or she can directly control to advance the campaign. That value is the source of the candidate influence that solicitation purchases for the dealer, and solicitation thus presents the same dangers as are caused by political contributions. See *FEC* v. *National Right to Work Comm.*, 459 U.S. 197, 207 (1982) (*NRWC*) ("substantial aggregations of wealth" through solicitation "could be used to incur political debts from legislators who are aided by the contributions"); *United States Civil Serv. Comm'n* v. *National Ass'n of Letter Carriers*, 413 U.S. 548, 556 (1973) (reaffirming constitutionality, in the interests of government impartiality and its appearance, of provisions preventing federal government employees from "actively participating in fund-raising activities for a partisan candidate or political party").

The appearance of corruption can be as harmful as the reality of corruption caused by contributions or solicitation. See *Buckley*, 424 U.S. at 27; *NRWC*, 459 U.S. at 210 (compelling interest in preventing appearance of corruption of federal electoral process). Public confidence in the municipal securities market is essential to the ability of state and local govern-

ments to raise capital in that market in order to carry out their important public functions. Rule G-37 was promulgated with respect to an industry where the need for regulation in furtherance of the highest ethical standards is well recognized. See, *e.g.*, *United States* v. *Naftalin*, 441 U.S. 768, 774-776 (1979).[8]

Petitioner contends (Pet. 16-17) that the Commission has not identified specific instances in which campaign contributions were a *quid pro quo* for consideration for or award of municipal securities business. See Pet. App. A16, B9-B12. But as this Court has recognized, "the scope of such pernicious practices can never be reliably ascertained," *Buckley*, 424 U.S. at 27, and, moreover, preventing the appearance as well as the reality of corruption is a compelling interest, *id.* at 26-27, 30. The record before the Commission established that there is virtually unanimous consensus among professionals and others knowledgeable in the municipal securities field that pay-to-play is a widespread problem. See C.A. App.

---

[8] The integrity of the municipal securities market is also a matter of substantial and legitimate concern to investors. The court of appeals quoted with approval the Commission's conclusion that, "if 'pay to play' is the determining factor in the selection of an underwriting syndicate, an official may not necessarily hire the most qualified underwriter for the issue." Pet. App. A17 (quoting *id.* at B32). When market forces are thus distorted, investor confidence in the market is impaired. Moreover, investors may suffer losses if underwriters who obtain business based on politics rather than skill fail properly to assess an offering's creditworthiness. The court of appeals did not, however, rely on the risk of harm to investors as a rationale supporting Rule G-37, see *id.* at A16-A17, and the compelling interest in preventing corruption (and the appearance of corruption) that distorts the market and prevents fair competition suffices to support the Rule, *id.* at A17-A18.

663-667, 1106-1108. As the court of appeals observed, petitioner himself acknowledged in a radio interview that giving or raising funds "does assure you at least you can get access to someone's office," that "most likely [state and local officials] are gonna call somebody who has been a political contributor," and that, other things being equal, officials will give business to their "friends" who have contributed. Pet. App. A15 (citing *Morning Edition: SEC Halts Political Campaign Funding from Wall Street* (National Public Radio broadcast, June 1, 1994)). The court correctly concluded that "no smoking gun is needed where, as here, the conflict of interest is apparent, the likelihood of stealth great, and the legislative purpose prophylactic." Pet. App. A16 (citing *NRWC*, 459 U.S. at 210).

b. Rule G-37 is narrowly tailored, placing only a modest burden on expressive conduct in order to serve the compelling interest in avoiding corruption. Rule G-37's burdens are significantly lighter than those imposed by the campaign contribution ceiling upheld in *Buckley* v. *Valeo*, *supra*. Like the contribution limit sustained in *Buckley*, section (b) of Rule G-37 "entails only a marginal restriction upon the contributor's ability to engage in free communication." *Buckley*, 424 U.S. at 20-21; see also Pet. App. A7. A campaign contribution limit is generally a minimal and indirect restraint on communication, and does not infringe the contributors' freedom to discuss candidates and issues. 424 U.S. at 21. The statutory provision at issue in *Buckley* placed a limit applicable across-the-board to contributions by *any* individual in *any* federal election. Rule G-37, by contrast, applies *only* to dealers and associated municipal finance professionals, and *only* to contributions to officials of

issuers with which the dealers engage in municipal securities business, in order to address in a focused manner the risk of corruption arising from their special business relationship to issuers. As this Court has repeatedly acknowledged, those who choose to participate in a closely regulated industry have more reason than do members of the general public to expect some impacts upon their rights and privileges. Cf. *Skinner* v. *Railway Labor Executives' Ass'n*, 489 U.S. 602, 627 (1989).[9]

The narrow manner in which both section (b) and section (c) are drawn leaves most political expression and association unaffected. The Rule applies only to limit dealers' contributions to and solicitation or coordination of contributions for officials of issuers with which they do (or seek to do) business; the dealers remain free to contribute money to or solicit contributions for any other campaign. It also permits a dealer to contribute money to and solicit for the campaigns of officials of issuers with which the dealer does business, provided that the business is granted based on competitive bids rather than through negotiated arrangements. Furthermore, municipal finance professionals may contribute up to $250 per candidate, per election, to any official for whom they are eligible to vote, even if the dealer with whom they are associated engages in municipal securities business with the issuer that employs that official. And the Rule is temporally limited: under section (b),

---

[9] Rule G-37's narrow focus on municipal securities dealers and the risks created by their business relationships with issuers distinguishes this case from *Carver* v. *Nixon*, 72 F.3d 633 (8th Cir. 1995), pet. for cert. pending, No. 95-1258 (filed Feb. 7, 1996), which struck down Missouri's across-the-board campaign contribution limits.

dealers may at any time choose to contribute to the campaigns of officials of an issuer, and although they then must refrain from doing municipal securities business with that issuer for two years, they may resume such business thereafter; under section (c), dealers may solicit and coordinate fundraising for an issuer official at any time during which the dealer is not doing business with, or seeking business from, the issuer.

Rule G-37 does not restrict dealers from continuing to express their support for a candidate in ways other than by contribution or solicitation, such as through one-on-one discussions, speeches, leaflets, letters, or written or broadcast editorializing. Dealers thus remain free in virtually every way to urge others to support a candidate—and to spend or solicit money for such efforts—as long as they do not contribute to the candidate, or ask for or coordinate contributions for the candidate.[10]

In that regard, a crucial limitation on Rule G-37 is that it leaves covered persons free to make unlimited *independent* expenditures in favor of candidates with whom they do (or may seek to do) business—*i.e.*, expenditures made without consultation or coordina-

---

[10] Petitioner complains (Pet. 10) that Rule G-37 prevents him from saying that a "candidate 'needs your financial support.'" But such a statement, like a contribution, is only an indirect expression of support for the candidate. See *Buckley*, 424 U.S. at 21. The Rule leaves dealers and municipal finance professionals free to express their support directly and to encourage others to support any candidate; they are free to say, for example, "I support candidate X, and you should, too." They are restricted only from asking for and coordinating financial contributions to the candidate. See Pet. App. A23-A24, C7-C8, D12-D13.

tion by a candidate or the candidate's campaign organization. Pet. App. B39; cf. 2 U.S.C. 431(17). Covered persons may also solicit contributions toward their own independent expenditures. The Court in *Buckley* viewed independent expenditures as implicating substantially greater expressive interests than contributions (and held that the independent expenditure limit before it in that case was unjustified in view of such expenditures' "diminished potential for abuse"). 424 U.S. at 47.

The type of restraint Rule G-37 imposes is not novel. Restraints on political contributions and on solicitation of contributions are imposed on corporations and government contractors under both federal and state law; federal law, for example, bans contributions by government contractors, and prohibits any solicitation from government contractors.[11] Thus,

---

[11] Federal law prohibits federal campaign contributions by federal contractors, and prohibits all persons from soliciting for federal campaigns from federal contractors. See 2 U.S.C. 441c(a)(1) and (2); 11 C.F.R. 115.2. Several States prohibit corporations or members of regulated industries from making campaign contributions in and/or soliciting for state elections. See, *e.g.*, Ariz. Rev. Stat. Ann. §§ 16-919, 16-921(B) (1995); Conn. Gen. Stat. Ann. § 9-333*o*(a) (West 1995); N.D. Cent. Code §§ 16.1-08-02(1), 16.1-08-01(10) (1991); Pa. Stat. Ann. tit. 25 § 3253 (1994); S.D. Codified Laws Ann. § 12-25-2 (1995); W. Va. Code § 3-8-8 (1994); see also W. Va. Code § 3-8-12(d) and (h) (1995); Wis. Stat. Ann. §§ 11.29, 11.38 (West 1986 & Supp. 1995); Wyo. Stat. § 22-25-102 (1992); see also 1995 Ct. ALS 188 (to be codified at Conn. Gen. Stat. Ann. § 1-84(n)) (prohibiting State from purchasing investment services from firms that have made contributions to or solicited contributions on behalf of candidates for state treasurer); Fla. Admin. Code Ann. r. 19A-6.004 (prohibiting award of municipal securities business to firms that make political contributions to the Governor or to cabinet members); Fla. Admin. Code Ann. r. 9I-16.004(e) (pro-

both federal and state laws embody the judgment that making contributions to government officials from whom one seeks business presents a serious ethical conflict.[12]

2. Petitioner also contends (Pet. 18-20) that Rule G-37 violates the Tenth Amendment, because, in his view, it regulates core sovereign activities of the States without an "unmistakably clear" congressional statement of intent to do so. Petitioner acknowledges that Congress has the authority to regulate the conduct at issue here, but challenges Rule G-37 on the ground that it was promulgated by the Commission.

The court of appeals correctly rejected petitioner's Tenth Amendment claim, however, recognizing that Rule G-37 simply does not affect "states' ability to control their own election processes." Pet. App. A26. No clear congressional statement is required here, because Rule G-37 regulates private conduct, not state activities. The Court in *Gregory* v. *Ashcroft*,

---

hibiting investment firms and law firms and their officers, directors, and employees that make contributions to or engage in fundraising for state-level candidates from competing for business from the Florida Housing Finance Agency).

[12] There is no reason for the Court to hold this case pending the disposition of *FEC* v. *Colorado Republican Campaign Comm.*, 59 F.3d 1015 (10th Cir. 1995), cert. granted, 116 S. Ct. 689 (1996) (No. 95-489), which involves limits on coordinated expenditures by political parties for public advertising in connection with federal election campaigns, not limits on individual municipal securities dealers' contributions to and solicitation for campaigns of state and local officials of issuers of municipal securities with whom they do business. Resolution of the issues presented in *Colorado Republican Campaign Comm.* is unlikely to have any bearing on the questions presented in this case.

501 U.S. 452 (1991), held that the Age Discrimination in Employment Act of 1967 (ADEA), 29 U.S.C. 621-634 (1988 & Supp. V 1993), could not, in the absence of "unmistakably clear" language in the Act, be applied to Missouri's mandatory-retirement rule for state judges, 501 U.S. at 460 (quoting *Atascadero State Hospital* v. *Scanlon*, 473 U.S. 234, 243 (1985)). The ADEA's text did not make clear whether it applied to state judges, and the Court thus held it inapplicable because to do otherwise would trench on States' authority "to determine the qualifications of their most important government officials." 501 U.S. at 463. Rule G-37, by contrast, does not affect the States' ability to select their officials; rather, it regulates the activities of municipal securities dealers engaged in interstate commerce. There is no suggestion in the record that Rule G-37 would impair election financing or any other aspect of state or local elections.[13] The Rule's potential indirect impact on the funding stream from municipal securities dealers to state candidates for offices responsible for issuing municipal securities is, in any event, insufficient to bring the rule within the ambit of the Tenth Amendment.[14]

---

[13] There was scant objection before the Commission—and there was none in the court below—from States or localities regarding the Rule's effect on federal-state relations. Some commentators suggested to the Commission that federal regulation was unnecessary or inappropriate because the pay-to-play problem should be handled at the state or local level, but none suggested that the Tenth Amendment prohibited the MSRB or the Commission from adopting rules on this subject. See C.A. App. 1110 n.16 (citing comments on federalism concerns).

[14] Petitioner's contention (Pet. 19-20) that the Commission's approval of this Rule was a "reversal of course" from the Com-

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

DREW S. DAYS, III
Solicitor General

RICHARD H. WALKER
General Counsel

PAUL GONSON
Solicitor

JACOB H. STILLMAN
Associate General Counsel

ERIC SUMMERGRAD
Principal Assistant General Counsel

MARK PENNINGTON
Senior Litigation Counsel
Securities and Exchange Commission

MARCH 1996

---

mission Chairman's testimony before Congress is incorrect. The Chairman made clear in his testimony that the MSRB's August 1993 draft Rule, which would have prohibited contributions for the purpose of obtaining business, was an approach that "represents a solid step in the right direction." C.A. App. 182. The Commission's order is fully consistent with the Chairman's representations to Congress.

(4)

Supreme Court, U.S.
FILED
MAR 14 1996
CLERK

No. 95-1063

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1995

WILLIAM B. BLOUNT,

Petitioner,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The District Of Columbia Circuit

---

REPLY BRIEF IN SUPPORT OF THE PETITION

KEVIN T. BAINE*
ROBERT B. BARNETT
ERIK S. JAFFE
KEVIN M. DOWNEY
WILLIAMS & CONNOLLY
725 12th St., N.W.
Washington, D.C. 20005
(202) 434-5000

ANDREW P. CAMPBELL
LEITMAN, SIEGAL, PAYNE & CAMPBELL, P.C.
600 North 20th St., Suite 400
Birmingham, Alabama 35203
(205) 251-5900

Attorneys for Petitioner

**Counsel of Record*

---

13 pp

TABLE OF AUTHORITIES

CASES:

Buckley v. Valeo,
424 U.S. 1 (1976) 1, 2, 3, 5, 8
Carver v. Nixon,
72 F.3d. 633 (1995), *pet.for cert. pending*, No. 95-1258 (filed Feb. 7, 1996) . . 1, 5, 6
FEC v. National Conservative Political Action Comm., 470 U.S. 480 (1985) 3
FEC v. National Right to Work Comm.,
459 U.S. 197 (1982) 1, 2, 3, 4, 8
First National Bank of Boston v. Bellotti,
435 U.S. 765 (1978) 1, 3, 4
NAACP v. Button,
371 U.S. 415 (1963) 3
R.A.V. v. City of St. Paul,
505 U.S. 377 (1992) 1
Sable Communications, Inc. v. FCC,
492 U.S. 115 (1989) 8
Shrink Missouri Gov't PAC v. Maupin, 71
F.3d. 1422 (1995) 1, 5, 6
Simon & Schuster v. New York Crime Victims Bd., 502 U.S. 105 (1991) 2
Turner Broadcasting Sys., Inc. v. FCC,
114 S. Ct. 2445 (1994) 1, 2, 4
United States Civil Serv. Comm'n v. National Ass'n of Letter Carriers,
413 U.S. 548 (1973) 6
Ward v. Rock Against Racism,
491 U.S. 781 (1989) 1, 7

CONSTITUTIONAL, STATUTORY AND REGULATORY PROVISIONS:

U.S. Const. amend. I 3, 5

2 U.S.C. § 441c(a) 7
2 U.S.C. § 441c(b) 7

11 C.F.R. § 115.2 7
11 C.F.R. § 115.3 7
11 C.F.R. § 115.4 7
11 C.F.R. § 115.6 7

Rule G-37 . . . . . *passim*

ARGUMENT

The essence of the position advanced by the SEC and the MSRB (together, "the government"), and adopted by the court of appeals, is that courts should not second-guess an administrative agency's determination of the need for prophylactic restrictions on political speech, even when those restrictions are based on content. That position rests on an interpretation of *FEC v. National Right to Work Committee ("NRWC")*, 459 U.S. 197 (1982), that is inconsistent not only with this Court's decision in *Buckley v. Valeo*, 424 U.S. 1 (1976), but also with its decisions in such cases as *First National Bank of Boston v. Bellotti*, 435 U.S. 765 (1978), and *Turner Broadcasting System, Inc. v. FCC*, 114 S. Ct. 2445 (1994), and with the Eighth Circuit's recent decisions in *Carver v. Nixon*, 72 F.3d 633 (1995), *pet. for cert. pending*, No. 95-1258 (filed Feb. 7, 1996), and *Shrink Missouri Government PAC v. Maupin*, 71 F.3d 1422 (1995).

1. The government does not dispute petitioner's assertion that Rule G-37's prohibition on the solicitation of political campaign contributions is a content-based regulation of speech.[1] Nor does it dispute that the Rule's ban on contributions is different not just "in degree," but "in kind," from a limit on the size of contributions. *Buckley*, 424 U.S. at 30.

Content-based restrictions are subject to "the most exacting scrutiny." *Turner Broadcasting*, 114 S. Ct. at 2459.

---

[1] It prohibits a particular message—"give money"—and the prohibition is not "'justified without reference to the content of the regulated speech.'" *Ward v. Rock Against Racism*, 491 U.S. 781, 791 (1989) (citation omitted). The prohibition is based on the fear that the message will be have a "persuasive effect" on the listener, *R.A.V. v. City of St. Paul*, 505 U.S. 377, 394 n.7 (1992), prompting action that the government believes might be harmful.

"There must be some pressing public necessity, some essential value that has to be preserved; and even then the law must restrict as little speech as possible to serve the goal." *Id.* at 2478 (O'Connor, J., concurring in part, dissenting in part).[2] Under *Buckley*, the same standard of review applies to contribution limitations and, *a fortiori*, to contribution bans. 424 U.S. at 16-17, 25.

2. While the court of appeals purported to apply "strict scrutiny," Pet. App. A-13, its opinion essentially redefined the task that strict scrutiny requires. As the court noted, "the record contains only *allegations*," not evidence or findings, Pet. App. A-16, and the record did not even contain *allegations* that *de minimis* contributions or *solicitations* had ever presented a problem. The court nevertheless upheld the contribution and solicitation bans, based on this Court's statement in *FEC v. NRWC* that it would not "second-guess a legislative determination as to the need for prophylactic measures where corruption is the evil feared." 459 U.S. at 210, *quoted at* Pet. App. A-16. *See also* MSRB Opp. 20; SEC Opp. 15.

---

[2] The speech at issue here does not fit into any of the limited categories of content-based restrictions that have been upheld. *See Simon & Schuster v. New York Crime Victims Bd.*, 502 U.S. 105, 124 (1991) (Kennedy, J., concurring in the judgment). It encourages entirely lawful activity in an arena in which the First Amendment "'has its fullest and most urgent application.'" *Buckley*, 424 U.S. at 15 (citation omitted). In this context, there are compelling reasons for the Court to adopt Justice Kennedy's position in *Simon & Schuster* that "borrowing the compelling interest and narrow tailoring analysis is ill-advised when all that is at issue is a content-based restriction." 502 U.S. at 124.

The court of appeals and the government have misconstrued *NRWC*. The quoted statement was uttered in the limited context of "a legislative judgment that the special characteristics of the corporate structure require particularly careful regulation." 459 U.S. at 209-10. Congress had made a "careful legislative adjustment of the federal electoral laws" over time—a "'cautious advance, step by step'"—that the Court felt warranted a degree of deference. *Id.* at 209 (citation omitted). But the Court made clear three years later that its reluctance to engage in "quibbling over fine-tuning of prophylactic limitations" did not signal that it would defer to legislative judgments that involved "wholesale restriction of clearly protected conduct." *FEC v. National Conservative Political Action Comm.*, 470 U.S. 480, 501 (1985). "[W]hen the First Amendment is involved," the Court emphasized, "our standard of review is 'rigorous.'" *Id.* (quoting *Buckley*, 424 U.S. at 29).

NRWC does not mean that courts must defer to legislative, much less administrative, assessments of the need for prophylactic rules that restrict speech on the basis of its content. To the contrary, the Court has always insisted that "[b]road prophylactic rules in the area of free expression are suspect." *NAACP v. Button*, 371 U.S. 415, 438 (1963). And the Court has not hesitated to set aside even acts of Congress that seek to impose restrictions on speech—even non-content-based restrictions—in the absence of record or legislative findings that the restrictions are necessary.

Thus, in *First National Bank of Boston v. Bellotti*, the Court struck down a law that prohibited banks and business corporations from making contributions or expenditures for the purpose of influencing the vote on any referendum, because the legislation was not "supported by *record or*

legislative findings that corporate advocacy threatened *imminently* to undermine democratic processes." 435 U.S. at 789 (emphasis added). Likewise, in *Turner Broadcasting*, the plurality concluded that Congress's "must-carry" legislation could not be sustained even under *intermediate* scrutiny without (1) an "elaboration . . . of the predictive or historical *evidence* upon which Congress relied," (2) "*findings* concerning the actual effects of must-carry on the speech of cable operators and cable programmers," and (3) "judicial *findings* concerning the availability and efficacy of 'constitutionally acceptable less restrictive means' of achieving the Government's asserted interests." 114 S. Ct. at 2472 (emphasis added, citation omitted). The court of appeals' approach, based on a misreading of *NRWC*, cannot be squared with *Bellotti* or *Turner*—or, for that matter, with the case upon which the government so heavily relies, *Buckley*. *See* Pet. 11-13.

To defer to the administrative determination of need in this case is to rob the notion of strict scrutiny of all meaningful content. The agencies proceeded without any evidence or findings—indeed, without even any allegations that small contributions or solicitations had ever posed a problem. And far from proceeding in a "cautious advance, step by step," *NRWC*, 459 U.S. at 209, the agencies in this case engaged in a headlong rush in the first instance to prohibit everything they imagined might ever be a problem.

Neither the MSRB nor the SEC can claim any expertise that warrants particular deference to this judgment: neither had any prior experience regulating election campaign activity. And neither evidenced any appreciation of the impact of their rule on the right to free speech. Indeed, the MSRB, which proposed the solicitation ban, thought that the

First Amendment was inapplicable to the rulemaking process. Although it tells this Court that "[i]n drafting and approving Rule G-37, the MSRB and SEC were sensitive to First Amendment concerns," MSRB Opp. 7, the fact is that the MSRB took the position at all times (until now) that it "is not a governmental actor" and that its rules "are not subject to constitutional constraints or review." JA 671. In short, the careful constitutional judgments that should have been made in the first instance by the MSRB were not made by the MSRB at all. Deference to administrative judgment in this case is deference to a phantom.[3]

3. The decision of the court of appeals in this case conflicts with two recent decisions of the United States Court of Appeals for the Eighth Circuit. In *Carver v. Nixon*, 72 F.3d 633 (1995), *pet. for cert. pending*, No. 95-1258 (filed Feb. 7. 1996), the court of appeals invalidated a state statute that limited individual campaign contributions to $100 to $300 per candidate. The court explained that the state had "made no showing as to why it was necessary to adopt" limits that differed not only "in degree", but "in kind," from the limits approved in *Buckley*. *Id.* at 644, 641. If, of course, a $300 contribution limit differs not only in degree, but in kind, from the limits in *Buckley*, so much more is that true of the flat-out prohibitions on certain contributions and solicitations in this case. Thus, in a companion case to *Carver*, the Eighth Circuit noted that "a ban on campaign contributions by organizations would not survive constitutional scrutiny."

---

[3] The SEC acknowledged that it was bound by the First Amendment, but it never recognized that the solicitation ban, which it intended as a loophole-closing device, in fact transformed the rule into a content-based regulation of speech. *See* Pet. App. B-38 n. 68.

Shrink Missouri Gov't PAC v. Maupin, 71 F.3d 1422, 1425 (8th Cir. 1995).[4]

In *Shrink*, the court also considered a "spend-down" provision requiring a candidate to return or forfeit unspent contributions. The court invalidated that provision because it was based on an "unwarranted assumption about the intention of campaign contributors"—that contributions that could be kept for future campaigns "must constitute an impermissible attempt at improper quid pro quo influence." 71 F.3d at 1427-28. Rule G-37(b)'s prohibition on contributions to candidates for whom the contributor is not entitled to vote is based on an equally "unwarranted assumption"—that such contributions are "motivated by an improper attempt to influence municipal officials." Pet. App. B-53. It is impossible to reconcile the reasoning and results in *Carver* and *Shrink* with the reasoning and result in this case.

4. The government attempts to minimize the significance of the court of appeals' decision by noting that federal government employees and federal government contractors are also subject to restrictions on their political activity. But it is well-established that "the government has an interest in regulating the conduct and 'the speech of its employees that differ[s] significantly from those it possesses in connection with regulation of the speech of the citizenry in general.'" *United States Civil Serv. Comm'n v. National Ass'n of Letter Carriers*, 413 U.S. 548, 564 (1973) (citation

---

[4] The government's distinction that the *Carver* limitations applied to all citizens ignores the court of appeals' recognition that the rationale for Rule G-37 would apply to anyone who has an interest in legislative or regulatory activity. Pet. App. A-12.

omitted). And the federal government does not impose any restriction on its contractors that is analogous to Rule G-37's prohibition on the solicitation of lawful contributions from others. Federal contractors may not make contributions, and no person may solicit an unlawful contribution *from* a contractor. 2 U.S.C. § 441c(a); 11 C.F.R. § 115.2. But there is no restriction on a federal contractor's soliciting contributions from third parties entitled to make such contributions.[5] Rule G-37 is the only provision of federal law that prohibits a private citizen from soliciting a *lawful* campaign contribution.

5. The government attempts to suggest that Rule G-37 should be upheld because those subject to its terms are not left without ways of expressing their political views. SEC Opp. 16-18; MSRB Opp. 7-8, 19. Of course, Rule G-37(c) does not leave open any alternative channel for communication of the particular message at issue here—"give money." More fundamentally, while the availability of "ample alternative channels for communication" is a factor to consider in reviewing a content-neutral time, place or manner regulation, *Ward v. Rock Against Racism*, 491 U.S. 781, 791 (1989), it cannot save a rule like Rule G-37. The issue with

---

[5] And notwithstanding the restrictions on contractors themselves, federal contractors may still establish segregated funds for the purpose of solicitation and contribution, and employees, major shareholders and corporate officers of federal contractors may still exercise their own personal rights to contribute, solicit, or participate in the political process just as any other citizen. 2 U.S.C. § 441c(b); 11 C.F.R. §§ 115.3, 115.4 & 115.6. Rule G-37, which extends beyond the contracting business entities to dealer affiliates and to individual municipal securities professionals, goes much further.

such a rule is not whether it leaves some avenues of speech unaffected; the issue is whether the rule could have foreclosed fewer avenues of speech—whether there was a less restrictive alternative.[6]

6. The government likens the interest behind Rule G-37 to the interest that was implicated in *Buckley* and *NRWC*. But the interest here is far more limited, and that too calls the court of appeals' decision into question. The decisions in *Buckley* and *NRWC* rested on the compelling governmental interest in preventing corruption, and the appearance of corruption, in the federal electoral process. But the securities agencies that produced Rule G-37 are powerless to invoke an interest in protecting the *electoral* process from corruption.[7] Their interest is of necessity limited to the protection of the securities market. And the court of appeals defined the relevant interest even more narrowly—the protection of underwriters and *not* the protection of investors. Pet. App. A-14 to A-18, A-21.

---

[6] The MSRB misstates the "least restrictive means" issue, *Sable Communications of California, Inc. v. FCC*, 492 U.S. 115, 126 (1989), as whether disclosure and record-keeping *alone* would have been effective. MSRB Opp. 21. The issue is whether those requirements, combined with contribution limitations (or, if necessary, a contribution ban) would have been effective, without the additional content-based prohibition on solicitations.

[7] They are likewise powerless to invoke the *states'* interests as employer or contracting party. Any state that feels a need to restrict its employees or contractors can enact such restrictions. Rule G-37 is thus either a superfluous measure or a paternalistic attempt to protect state interests that states themselves feel is unnecessary or undesirable.

In the final analysis, the government's oppositions, like the court of appeals' opinion, fail altogether to explain how this limited interest, on this record, can sustain Rule G-37's drastic provisions. The MSRB argues that there is a risk that "government officials will choose dealers . . . for the *size* of [their] campaign contributions." MSRB Opp. 13 (emphasis added). But that risk, if real, can at most support a limit on the *size* of contributions. There has never been a suggestion that an issuer would be influenced by a mere $250.

The MSRB argues that dealers may be coerced to make or solicit contributions. *Id.* But there is no evidence that anyone has ever been coerced to make a contribution, much less to solicit one from someone else. And the fear that some dealer might be coerced someday to solicit a contribution cannot, in any event, justify a content-based restriction on the speech of a dealer who willingly seeks to exercise his First Amendment rights.

The oppositions of the MSRB and SEC to the petition are as vague and imprecise in their justification of this rule as were their explanations at the time of the rule's promulgation. Now as then, newspaper accounts substitute for evidence,[8] and speculation takes the place of findings.[9] Surely more is

---

[8] *See, e.g.*, Pet. App. B-9 to B-12 (citing press stories); MSRB Opp. 5, 13 (same); SEC Opp. 4 (same).

[9] *See, e.g.*, Pet. App. B-8 ("Selection *may* be based on non-meritorious considerations"), B-28 to B-29 ("*If* underwriter selection is swayed by political contributions or influence, underwriters *may* be chosen based on" contributions), B-30 ("'pay to play' practices *may* damage" securities market), B-30 ("*If*

(continued...)

required to support Rule G-37's drastic and unprecedented restraint on political speech.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

KEVIN T. BAINE*
ROBERT B. BARNETT
ERIK S. JAFFE
KEVIN M. DOWNEY
WILLIAMS & CONNOLLY
725 12th St., N.W.
Washington, D.C. 20005
(202) 434-5000

ANDREW P. CAMPBELL
LEITMAN, SIEGAL, PAYNE & CAMPBELL, P.C.
600 North 20th St., Suite 400
Birmingham, Alabama 35203
(205) 251-5900

Attorneys for Petitioner

**Counsel of Record*

March 14, 1996

---

[9](...continued)
political influence is the determinative factor . . . , the underwriter selected *may* be less . . . competent"); MSRB Opp. 4 ("dealers *might* well be in a position to provide substantial sums of money"), 5 ("campaign contributions *could* influence" dealer choice); SEC Opp. 4 ("widespread *potential* for abuse), 6 ("Pay-to-play *may* result in business being awarded" based on contributions), 7 ("underwriter selected on the basis of political contributions . . . *may* fail to carry out its obligations").